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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1939

No. 479

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES A. BRUUN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 21, 1939
CERTIORARI GRANTED NOVEMBER 22, 1939

United States Circuit Court of Appeals

EIGHTH CIRCUIT.

No. 11,429

TAX REVIEW.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

vs.

CHARLES A. BRUUN, RESPONDENT.

ON PETITION TO REVIEW DECISION OF UNITED STATES BOARD OF TAX APPEALS.

FILED FEBRUARY 15, 1939.

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[fol. 1] Docket Entries.

Charles A. Bruun, Petitioner,
Docket No. 89454. vs.
Commissioner of Internal Revenue, Respondent.

Appearances.

For Taxpayer: L. E. Durham, Esq., Wm. J. Carroll, Esq., Wright Conrad, Esq., John H. McEvers, Esq., Reece A. Gardner, Esq.,

For Comm'r.: W. W. Kerr, Esq.

1937

Jun. 14—Petition received and filed. Taxpayer notified. (Fee Paid.)

" 14—Copy of petition served on General Counsel.

" 29—Notice of the appearance of L. E. Durham as counsel for taxpayer filed.

Jul. 15—Answer filed by General Counsel.

" 24—Copy of answer served on taxpayer.

Aug. 6—Motion for circuit hearing in Kansas City filed by taxpayer. 8/7/37 granted.

Sep. 7—Notice of the appearance of Wright Conrad as counsel for taxpayer filed.

1938

Aug. 24—Hearing set Oct. 17, 1938 at Kansas City, Missouri.

Sep. 19—Notice of appearance of John H. McEvers and Reece A. Gardner as counsel for taxpayer filed.

Oct. 17—Hearing had before Mr. Opper, Div. 14 on merits. Submitted. Stipulation of facts filed at hearing. Judgment for the petitioner. No briefs.

" 21—Transcript of hearing of Oct. 17, 1938, filed.

" 22—Memorandum opinion rendered, Clarence V. Opper, Div. 14. Decision will be entered for the petitioner.

" 22—Decision entered, C. R. Arundell, Div. 7.

1939

Jan. 6—Petition for review by U. S. Circuit Court of Appeals (8) with assignments of error filed by General Counsel.

" 18—Proof of service filed by General Counsel. (4) 3 Attorneys and taxpayer.

" 30—Praecipe for record filed by General Counsel.

Feb. 7—Proof of service of praecipe filed by General Counsel. (2) Attorneys.

[fol. 2] (Petition of Charles A. Bruun for Appeal.)

(Filed June 14, 1937, U. S. Board of Tax Appeals.)

United States Board of Tax Appeals.

Charles A. Bruun, Petitioner;
Docket No. 89454. vs.
Commissioner of Internal Revenue, Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the respondent in his notice of deficiency (Bureau symbols IT:C:1 SB 90D), dated March 17th, 1937, and as a basis for his proceeding alleges as follows:

1. The petitioner is an individual, residing at No. 8619 Holmes Street, Kansas City, Missouri.

2. That the notice of deficiency (copy of which, together with copy of so much of the statement accompanying the same as is material hereto, marked respectively Petitioner's Exhibits 1 and 2, are hereto attached) was mailed to petitioner on, to-wit, March 17th, 1937.

3. The taxes in controversy are income taxes for the calendar year 1933 in the amount of, to-wit, Four Thousand One Hundred Eleven and 43/100 Dollars ($4,111.43).

[fol. 3] 4. The determination of tax set forth in said notice of deficiency is based upon the following errors, to-wit:

(a) Respondent erred in adding, under Section 22(a) of the Revenue Act of 1932, and Article 63 of Regulations 77, as amended by Treasury Decision 4539, Internal Revenue Cumulative Bulletin XIV-I, page 141, the sum of, to-wit, Fifty-One Thousand Four Hundred Thirty-Four and 25/100 Dollars ($51,434.25) as income derived by petitioner during the calendar year 1933 on or from the cancellation of the 99-year lease referred to in [respondent's] written statement (Petitioner's Exhibit a), for the reason that petitioner did not derive any income whatsoever on or from the cancellation of said lease within the meaning of Amendment Sixteenth of the Constitution of the United States of America.

(b) Respondent erred in adding, under Section 22(a) of the Revenue Act of 1932, and Article 63 of Regulations 77, as amended by Treasury Decision 4539, Internal Revenue Cumulative Bulletin XIV-I, page 141, the sum of, to-wit, Fifty-One Thousand Four Hundred Thirty-Four and 25/100 Dollars ($51,434.25), as income derived by petitioner during the calendar year 1933 on or from the cancellation of the 99-year lease referred to in respondent's written statement (Petitioner's Exhibit 2), for the reason that said Section 22(a) of the Revenue Act of 1932, and said Article 63 of Regulations 77, as amended by said Treasury Decision 4539, as applied by respondent to the cancellation [fol. 4] of the lease aforesaid, and to the improvements erected under said lease upon the land thereby let, imposes on the property of petitioner a direct property tax not apportioned in accordance with the population of the States, in contravention of Section 2 of Article I of the Constitution of the United States of America.

(c) Respondent erred in adding, under Section 22(a) of the Revenue Act of 1932, and Article 63 of Regulations 77, as amended by Treasury Decision 4539, Internal Revenue Cumulative Bulletin XIV-I, page 141, the sum of, to-wit, Fifty-One Thousand Four Hundred Thirty-Four and 25/100 Dollars ($51,434.25) as income derived by petitioner during the calendar year 1933 on or from the cancellation of the 99-year lease referred to in [respond-

ent'w] written statement (Petitioner's Exhibit 2), in that he thereby deprived petitioner of petitioner's property, to-wit, said sum of Four Thousand One Hundred Eleven and 43/100 Dollars ($4,111.43) without due process of law, in violation of the Constitution of the United States of America, Amendment Fifth.

(d) Respondent erred in failing to deduct from the value, if any, of the improvements hereinafter mentioned, liens for accrued taxes and unpaid rent in the amounts hereinafter respectively alleged.

(e) The actions of respondent complained of herein were arbitrary and without warrant or authority in law.

[fol. 5] 5. The facts upon which petitioner relies as the basis of this proceeding are as follows:

(a) On July 1st, 1915, petitioner owned land in Kansas City, Jackson County, Missouri, described as follows, to-wit:

All of Lot Eighty-Seven (87) in Swope's Addition to the City of Kansas (now Kansas City), Missouri, as the same is shown, marked and designated upon the plat of said addition on file and of record in the office of the Recorder of Deeds of Jackson County, Missouri, subject, however, to such right as Kansas City may have to use for street purposes as a part of Twelfth Street a strip off the south side thereof supposed to be about six feet in width from north to south.

(b) On July 1st, 1915, by an agreement in writing, petitioner leased to Newmarket Investment Company (hereinafter sometimes referred to as "lessee"), a Missouri corporation, the above described lands for a term of ninety-nine (99) years from and including July 1st, 1915, to and including June 30th, 2014; that by said lease said lessee bound itself to pay certain rents for said land, which rents, during the year 1933, were payable at the rate of Twenty-Five Hundred Dollars ($2500.00) per month; and bound itself and agreed to pay promptly, before the same became delinquent and subject to penalties, all taxes, assessments or charges then or thereafter levied, laid, assessed or charged by any governmental authority under any then present or future law, upon or against said land or any

part thereof, or upon or against the buildings or improvements then or thereafter situated thereon or any part thereof, and continually to keep all said lands and all such build-
[fol. 6] ings and improvements and every right, title, interest or estate therein or thereto, free, clear and discharged of every such lien and incumbrance; that by the terms of said lease it was agreed between petitioner and said lessee that said lessee should have the right to tear down and remove any and all buildings then situated on said land and to take away the materials composing the same, and that lessee might at different times remove or tear down separate buildings then or thereafter situated upon said lands and take away the materials composing the same; Provided, that no such building should be removed or torn down after the year 2010, and that no building should be torn down or removed after said lease was forfeited, cancelled or in any way terminated.

Petitioner and said lessee further by said lease agreed that at such time as petitioner should recover or take possession of said land on account of any breach of any agreements, covenants or stipulations in said lease contained, or at the expiration of the term thereof by lapse of time, or other termination of said lease, all buildings, fixtures, appliances and improvements placed on said land, or any part or parts thereof, should become, be and remain the property of petitioner, and that the lessee should at any such time yield up the same to petitioner without compensation therefor; that in case said lessee should fail to pay the rents in said lease reserved at the time and place therein provided, or if it should fail to keep and perform any of the other covenants, agreements or stipulations
[fol. 7] therein contained, by said lessee to be kept and performed, then such lease might, at the option of petitioner, be and become forfeited, null, void and of no effect; that the said lease might, with the consent of petitioner, be by said lessee assigned; that said lessee was not by said lease bound or obligated to construct or build any building on said land, but that if it proceeded so to do, it was required to do so at its own cost and expense.

(c) That the leasehold estate created by said written agreement was by said lessee, by its deed of trust dated November 1, 1929, conveyed to one William E. Graves,

as Trustee, in security for a certain indebtedness in said deed of trust described.

(d) That on or about April 26th, 1933, said William E. Graves, Trustee, duly advertised and sold the interest of said Newmarket Investment Company in said leasehold estate to Newmarket Holding Company, a Missouri corporation.

(e) That thereafter default was made in the payment of the rent due for said premises for the month beginning June 1st, 1933, and that default was made in the payment of taxes assessed against said land and improvements thereon aggregating the amount of, to-wit, Eight Thousand Two Hundred Thirty-Seven and 41/100 Dollars ($8,237.41), and that petitioner duly gave notice of his intention to declare a forfeiture of said lease for failure to pay said rent and said taxes.

[fol. 8] (f) That thereafter said Newmarket Holding Company did, on or about the 29th day of June, 1933, convey to petitioner by quitclaim deed, and surrender said lease, and the same was by petitioner terminated.

(g) Petitioner further states that prior to the date of the termination of said lease said Newmarket Investment Company had removed buildings and improvements on said land existing at the date of said lease and had erected thereon the improvements here involved, and that said last mentioned improvements were situated on said land at the date of the termination of said lease.

(h) Petitioner states that said land and improvements at the date of termination of said lease were subject to liens for unpaid taxes, as aforesaid, in the amount of Eight Thousand Two Hundred Thirty-Seven and 41/100 Dollars ($8,237.41), and that the fair value of said improvements was reduced to the extent of said [liend].

(i) Petitioner states that the aforesaid improvements on said land at the date of cancellation of said lease were affixed to, had become and were a part of said land, and had no existence separate and apart from said land.

(j) Petitioner further states that at the date of termination of said lease he did not lease and could not have

leased said land or said land and improvements for any term whatever upon conditions as favorable to him as those contained in said lease.

[fol. 9] (k) Petitioner further states that the cost of said improvements, as calculated by respondent and shown upon his said statement (Petitioner's Exhibit 2) does not reflect the fair value of said improvements, in that respondent did not deduct therefrom the aggregate amount of the taxes and rent unpaid, as aforesaid, at the date of the termination of said lease.

(l) Petitioner further states that by reason of the business depression at the date of the cancellation of said lease and still existing, the cost of said improvements as calculated by respondent upon his said statement (Petitioner's Exhibit 2) did not reflect the fair value of said improvements, and that on the contrary said improvements at the date of cancellation of said lease were worthless and without value.

(m) Petitioner further states that the existence of said improvements at the date of termination of said lease greatly impaired the lease value of said land, in that had said Newmarket Investment Company removed the same therefrom under the terms of said lease, said lot, unimproved, could have been readily leased for automobile parking purposes.

Wherefore, petitioner prays that this Honorable Board may hear this proceeding and determine that there is no deficiency due from petitioner for income taxes for the [fol. 10] calendar year 1933.

L. E. DURHAM,
WRIGHT CONRAD,
WILLIAM J. CARROLL,
Counsel for Petitioner,
901 National Fidelity Life Building,
Kansas City, Missouri.

State of Arkansas,
County of Garland.—ss.:

Charles A. Bruun, being first duly sworn, says that he is the petitioner above named; that he has read the foregoing

petition and is familiar with the statements contained therein and that the facts there stated are true.

CHARLES A. BRUUN.

Subscribed and sworn to before me this 11th day of June, 1937.

(Seal) ELIZABETH CANADAY,
Notary Public.

My commission expires May 17, 1938.

[fol. 11] Petitioner's Exhibit 1.

(SEAL)

Treasury Department
Washington

Office of
Commissioner of Internal Revenue

Mar. 17, 1937.

Mr. Charles A. Bruun,
8619 Holmes Street,
Kansas City, Missouri.

Sir:

You are advised that the determination of your income tax liability for the taxable year(s) 1933 discloses a deficiency of $4,111.43, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this

form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By Chas. T. Russell,
Deputy Commissioner.

Enclosures:
Statement
Form 870

[fol. 12] Petitioner's Exhibit 2.

Statement

IT:C 1
SB-90D

In re: Mr. Charles A. Bruun,
8619 Holmes Street,
Kansas City, Missouri.

Income Tax Liability

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1933	$4,111.43	None	$4,111.43

The deficiency shown herein is based upon the report dated August 27, 1935, prepared by Revenue Agent E. R. Graham, a copy of which was transmitted to you and upon such adjustments as are shown below.

Careful consideration has been given to your protests dated October 4, 1935 and January 27, 1937 in connection with the report of the internal revenue agent in charge and the information submitted at conferences held in the office of that official.

You hold that the value of improvements reverting to you upon the cancellation of a ninety-nine year lease does not represent income and that the provisions of Treasury Decision 4539 (published in Internal Revenue Cumulative Bulletin XIV-1, page 141) amending article 63 of Regulations 77 are invalid. You rely upon the decision in the

case of the Hewitt Realty Company, 76 Fed. (2d) 880, C. C. A. 2. You are advised that the decision in this case is not being followed by the Bureau.

You contend also that the appraised value of $82,609.92 found by the revenue agent is greatly in excess of the reasonable market value of the improvements as of July 1, 1933.

The question of the value of the improvements as of July 1, 1933 has been given consideration and it is held, upon the basis of the information on file, that the value of the improvements as of that date is $64,245.68.

[fol. 13]

Computation of your revised income and tax liability follows:

Net loss reported on return		($18,317.08)
Add:		
1. Profit on cancellation of lease	$51,434.25	
2. Other deductions	974.84	52,409.09
Total		$34,092.01
Deduct:		
3. Additional depreciation	$ 642.93	
4. Capital loss	974.84	1,617.77
Total net income adjusted		$32,474.24
Plus:		
Capital net loss included		974.84
Ordinary net income adjusted		$33,449.08
Less:		
Personal exemption		2,500.00
Net income subject to normal tax		$30,949.08
Normal tax at 4% on $ 4,000.00		$ 160.00
Normal tax at 8% on $26,949.08		2,155.93
Surtax on $33,449.08		1,917.36
Total		$ 4,233.29
Less:		
12½% of capital net loss $974.84		121.86
Balance		$ 4,111.43
Corrected income tax liability		$ 4,111.43
Income tax assessed, original, account #68928		None
Deficiency		$ 4,111.43

[fol. 14] Explanation of Changes.

1. Treasury Decision 4539, published in Internal Revenue Cumulative Bulletin XIV-1, page 141, provides in part as follows:

"If the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor shall report income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he becomes entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements."

It appears that no income has been previously reported by you from the improvements, since the life of the building was less than the remaining term of the lease. Gain on the cancellation of a lease after the lessee had erected a new building on premises at Twelfth Street and Grand Avenue has, therefore, been determined as follows:

Value of building on July 1, 1933		$64,245.68
Deduct:		
Unextinguished cost of old buildings demolished in 1929	$13,365.00	
Less:		
Amortization based on leasehold to 1933;		
Date of ninety-nine-year lease, July 1, 1915		
Remaining life of lease on December 31, 1929 84½ years		
$13,365.00 ÷ 84½ equals $158.165		
December 31, 1929 to July 1, 1933 3½ years		
3½ years at $158.165 per year equals	553.57	12,811.43
Income upon cancellation of lease in 1933		$51,434.25

[fol. 15] (Answer of Commissioner of Internal Revenue.)

(Filed July 15, 1937, United States Board of Tax Appeals.)

United States Board of Tax Appeals.

Charles A. Bruun, Petitioner,

Docket No. 89454. vs.

Commissioner of Internal Revenue, Respondent.

The Commissioner of Internal Revenue, by his attorney, Morrison Shafroth, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed by the above-named taxpayer, admits and denies as follows:

1. Admits the allegations of paragraph 1.

2. Admits the allegations of paragraph 2.

3. Admits the taxes in controversy are income taxes for the calendar year 1933. Denies the remainder of the allegations contained in paragraph 3.

4-(a), (b), (c), (d) and (e). Denies the Commissioner erred in respect to the matters alleged in subparagraphs (a), (b), (c), (d) and (e) of paragraph 4.

5-(a). Admits on July 1, 1915 the petitioner owned land in Kansas City, Jackson County, Missouri, at the Northeast corner of 12th Street and Grand Avenue. Denies the remainder of the allegations contained in subparagraph (a) of paragraph 5.

5-(b). Admits on July 1, 1915 by an agreement in writing petitioner leased to Newmarket Investment Company the above-described lot for a term of 99 years. Denies the remainder of the allegations contained in subparagraph (b) of paragraph 5.

[fol. 16] 5-(c). Denies the allegations contained in paragraph 5-(c).

5-(d). Denies the allegations contained in paragraph 5-(d).

5-(e). Denies the allegations contained in paragraph 5-(e).

5-(f). Admits the lease was surrendered to the petitioner on or about June 29, 1933. Denies the remainder of the allegations contained in subparagraph (f) of paragraph 5.

5-(g). Admits that prior to the date of the termination of the said lease certain buildings and improvements on said land existing at the date of the said lease were removed and new buildings and improvements were made thereon, which were situated on said land at the date of the

termination of the said lease. Denies the remainder of the allegations contained in subparagraph (g) of paragraph 5.

5-(h). Denies the allegations contained in paragraph 5-(h).

5-(i). Denies the allegations contained in paragraph 5-(i).

5-(j). Denies the allegations contained in paragraph 5-(j).

5-(k). Denies the allegations contained in paragraph 5-(k).

5-(l). Denies the allegations contained in paragraph 5-(l).

5-(m). Denies the allegations contained in paragraph 5-(m).

6. Denies generally and specifically, each and every allegation contained in taxpayer's petition, not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

MORRISON SHAFROTH,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
J. E. Marshall,
C. R. Marshall,
Special Attorneys,
Bureau of Internal Revenue.

CRM 7-13-37.

[fol. 17] Stipulation of Facts.

(Filed at Hearing October 17, 1938, U. S. Board of Tax Appeals.)

United States Board of Tax Appeals.

Charles A. Bruun, Petitioner,
Docket No. 89454 vs.
Commissioner of Internal Revenue, Respondent.

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that the material facts herein are as follows:

1. Charles A. Bruun, the petitioner herein, is and at all of the times hereinafter mentioned was an individual and a resident of Kansas City, Jackson County, Missouri.

2. Between and including the first day of July, 1915, and the first day of July, 1933, petitioner owned Lot Eighty-seven (87) in Swope's Addition to the City of Kansas (now Kansas City), Missouri, which is located at the Northeast corner of Twelfth Street and Grand Avenue.

[fol. 18] 3. On July 1, 1915, petitioner leased the said real estate for a term of ninety-nine years to Newmarket Investment Company, a corporation, under a written indenture of lease, copy of which is attached hereto, marked "Exhibit A."

4. At the time of the execution of said lease there was a building upon said property and said building remained thereon until 1929. At that time it had an undepreciated cost to the petitioner of $13,365. During 1929, the lessee demolished and removed said building from the premises and prior to December 31, 1929, the lessee constructed a new building upon said premises, which had a useful life of not more than fifty years.

5. The lessee continued to occupy the premises and pay the rent provided for in said lease until March, 1933, when it defaulted in the payment of rent.

6. On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was cancelled and the property, together with the building then thereon, turned over to the petitioner.

7. It is further stipulated and agreed that as at said date, July 1, 1933, the building which had been erected upon said premises by the lessee had a fair market value of $64,245.68 and that the unamortized cost of the old building, which was removed from the premises in 1929 to make way for the new bulding, was $12,811.43, thus leaving a net fair market value as at July 1, 1933, of $51,434.25, for the aforesaid new building erected upon the premises by the lessee.

[fol. 19] 8. On or before March 15, 1934, the petitioner filed with the Collector of Internal Revenue for the Sixth

Internal Revenue Collection District at Kansas City, Missouri, a federal income tax return, in which he did not report any income as resulting to him from the cancellation of the above lease and the taking of possession by him of said property. In auditing his return the Commissioner of Internal Revenue determined that as a result of said transaction he sustained a net gain of $51,434.25, being the difference between $64,245.68, the aforesaid value on July 1, 1933, of the building erected upon said premises by the lessee, and $12,811.43, the adjusted cost base of the building demolished and removed from the premises by the lessee in 1929. Accordingly, he determined a deficiency of $4,111.43, and on March 17, 1937, forwarded the petitioner notice thereof. A copy of said notice is attached to the petition filed herein and marked "Petitioner's Exhibit 1."

9. If the Commissioner of Internal Revenue properly included in the gross income of the petitioner for 1933 the fair market value as of that time of the building constructed upon said premises by the lessee, the deficiency herein is $4,111.43. On the other hand, if his action in including the fair market value of said building in income of the petitioner was erroneous, there is no deficiency in tax.

[fol. 20] Dated this 11th day of October, 1938.

By John H. McEvers,
Reece A. Gardner,
Counsel for Petitioner.

J. P. Wenchel,
Chief Counsel for Bureau of Internal Revenue,
Counsel for Respondent.

[fol. 21] Exhibit A.

This Indenture Made this First day of July, Nineteen hundred and fifteen, by and between Charles A. Bruun, first party and Myrtle M. Bruun, his wife, second party and Newmarket Investment Company, a corporation created, organized and existing under and by virtue of the laws of the State of Missouri, third party, Witnesseth:

In consideration of the rents, covenants and agreements to be paid, kept and performed by third party as herein set out and subject to all the terms, conditions and agreements herein contained first party does hereby let, demise and lease, in the present condition thereof, unto the third party, for a term of ninety-nine (99) years, running from and including the First day of July, Nineteen hundred and fifteen up to and including the Thirtieth day of June, Two thousand and fourteen, land in Kansas City, in Jackson County, Missouri, described as follows, to-wit:

All of Lot Eighty-seven (87) in Swope's Addition to the City of Kansas (now Kansas City), Missouri, as the same is shown, marked and designated upon the plat of said addition on file and of record in the office of the Recorder of Deeds of Jackson County, Missouri, subject, however, to such right as Kansas City may have to use for street purposes as a part of Twelfth Street a strip off the south side thereof supposed to be about six feet [fol. 22] in width from north to south. Said land is let, demised and leased subject to the lien of all taxes and assessments that can not at the date hereof be paid and also subject to three certain leases for certain portions of the buildings at present upon the said lands, all of which leases expire at the end of June, Nineteen hundred and seventeen and being one lease dated the seventeenth day of September, Nineteen hundred and four made by James A. Bruun, as lessor, to Fred C. Morris, as lessee, which lease has been modified by agreement between Charles A. Bruun and Fred C. Morris, dated the fifth day of August, Nineteen hundred and eight; and one lease made by James A. Bruun, as lessor, to Abijah J. Brooks, as lessee, dated the second day of November, Nineteen hundred and four; and one lease made by Charles A. Bruun, as lessor, to Pabst Brewing Company, as lessee, dated the thirteenth day of December, Nineteen hundred and eleven, and the first party does hereby assign and transfer unto the said third party all rents payable under the said last three mentioned leases that may become due and payable while this lease remains in force and effect.

And for same consideration the said second party does hereby release unto the said third party all her right of dower in and to the said lands for and during and only

for and during the time that this instrument of lease may remain in force and effect.

It is further agreed by and between the parties hereto as follows:

[fol. 23] First: The third party shall, as rent for the said land, without any demand made therefor, pay to the first party, his heirs, devisees or assignees, in lawful money of the United States, the following sums at the times following, to-wit: Five thousand Dollars ($5000.00) at the delivery hereof, receipt whereof is hereby acknowledged, and One thousand Dollars ($1000.00) on the First day of each calendar month from and including the First day of July, Nineteen hundred and fifteen, up until the First day of July, Nineteen Hundred and eighteen and One thousand Six hundred and Sixty-six and 66/100 Dollars ($1666.66) on the First day of each calendar month from and including the First day of July, Nineteen hundred and eighteen up until the First day of July, Nineteen hundred and twenty-two and Two Thousand and Eighty-three and 33/100 Dollars ($2083.33) on the First day of each calendar month from and including the First day of July, Nineteen hundred and twenty-two up until the First day of July, Nineteen hundred and twenty-five and Two thousand Five hundred Dollars ($2500.00) on the First day of each calendar month from and including the First day of July, Nineteen hundred and twenty-five up until the First day of July, Two thousand and Fourteen.

Second: Said payments of rent shall be made at the office of Citizens' Savings Trust Company in Kansas City, Missouri, until some other place of payment may under the terms hereof be designated by the person or persons to whom the rent may under the terms hereof be payable. The person or persons to whom from time to time the rent [fol. 24] under the terms hereof is payable may from time to time designate the office of any bank or trust company in Kansas City, Missouri, as the place at which payments of rent thereafter maturing shall be made but notice in writing of any change of place of payment shall be given by the person or persons to whom at the time of such notice the rent may be payable, to the third party at least thirty (30) days in advance of the first payment required

to be made at any new place and after thirty (30) days from the giving of said notice all subsequent payments of rent shall be made at the place so designated until some other place may be designated. If at any time the original or any designated place of payment shall not exist and no other place of payment shall have been designated then the rent shall be paid on the premises hereby leased and as near the southwest corner thereof as can be conveniently done.

The receipt of the bank or trust company at whose office rents are from time to time payable shall fully discharge third party from any and all obligation to first party for the rental duly paid and so receipted for, without further evidence of the payment thereof. Provided, however, that the third party shall withhold from the monthly payments of rents aforesaid any tax on income required by law to be so withheld or any other tax required by law to be so withheld and paid by said third party.

Third: The third party shall pay promptly before the same become delinquent and before the same become subject to penalties all taxes, assessments or charges now or [fol. 25] hereafter levied, laid, assessed or charged by any country, government, state or municipality, or by any governmental authority or pursuant to any proceedings under any present or future law, upon or against said lands, or any part thereof, or upon or against any buildings or improvements now or hereafter situate thereon, or any part thereof, or upon or against any right, title, interest or estate in or to said lands, buildings, improvements, or any part or parts thereof, and continually keep all the said lands and all buildings and improvements now or hereafter situate thereon and every right, title, interest or estate in or to said lands, buildings or improvements, free, clear and discharged of every lien or incumbrance created by any present or future law, or created pursuant to any proceedings under any present or future law, it being provided, however, that if the said third party shall claim that any such tax, assessment, charge, lien or incumbrance is not lawful and shall within sixty (60) days after the first day any such tax, assessment, charge, lien or incumbrance could be paid notify the first party in writing of any such claim

that any such tax, assessment, charge, lien or incumbrance is not lawful, stating the reasons for such claim, then any such tax, assessment, charge, lien or incumbrance need not be paid until final judgment is had thereon, except, however, that if by provision of law a sale of said lands, buildings or improvements, or any part or parts thereof, or any right, title, estate or interest therein, may then be by law allowed to be made to pay or enforce any such tax, assessment, charge, lien or incumbrance without any final judgment being had, then even in case such notice is given [fol. 26] such tax, assessment, charge, lien or incumbrance shall be paid by third party at least ten (10) days before any such sale can be had. In case of failure of third party to pay any such tax, assessment, charge, lien or incumbrance at the time it is bound to pay the same under the provisions hereof then the first party may pay and discharge the same, or any judgment therefor, with all interest, costs and charges, without inquiring into the validity or lawfulness of the same and no matter whether the same be valid or lawful or not, and the third party will repay to first party the sum or sums so paid and for the sum or sums so paid by the said first party he shall, in addition to any other rights, remedies or actions agreed upon by the provisions of this lease or allowed by law, have a lien upon the interest of the third party in this lease and in said lands and in any buildings or improvements hereafter situate on said lands. Election by first party to pay as just hereinbefore set out shall not be deemed a waiver by him of any remedies or rights of forfeiture herein or by any present or future law given to him on account of the failure of third party to pay but the same shall remain and exist in force not-with-standing the payment by first party. On or before the tenth day of January and August of each year the third party shall leave for the first party at the place where the rent is then payable a certificate duly certified by a competent abstractor or proper public official showing that all such taxes, assessments, charges, liens and incumbrances agreed to be paid by third party have been [fol. 27] paid and discharged and that the interest of the first and third party in the said lands, buildings and improvements is free of all liens created by or pursuant to any present or future law or pursuant to any proceedings

under any present or future law which third party is bound to then pay but it is expressly provided, however, that nothing in this paragraph or in this instrument contained shall bind or subject third party to pay any such charges as are commonly known as and called inheritance taxes, nor any such charges as are commonly known as and called income taxes.

Fourth: The third party upon executing and delivering the bond hereinafter mentioned may whenever it chooses remove or tear down any building or buildings then situate on said land and take away the materials composing the same.

Before beginning to remove or tear down any building or buildings now situate on said land the third party shall execute and deliver to first party its bond for a penal sum equal to the rent of the said land for the next two years immediately following the date of said bond and before beginning to remove or tear down any building or buildings hereafter erected on said land the third party shall execute and deliver to first party its bond for the penal sum of sixty thousand dollars ($6000.00). Each and every bond so executed and delivered shall also be executed and delivered by some responsible person or persons or corporation as surety or sureties and shall be conditioned that the third party will for two years after beginning to so remove [fol. 28] or tear down pay to the person or persons to whom by the terms hereof the same are agreed to be paid, all rents by the terms of this lease agreed to be paid and during said two years perform all agreements and obligations contained in this lease and required by the terms of this lease to be performed by the third party. The said bond shall recite that it is given for the benefit of all persons who may during the said term of two years be entitled to receive such rents or enforce such agreements or obligations and shall be construed to be made for the benefit of all such persons and may be enforced by them or any of them. The third party may under the terms hereof at different times remove or tear down separate buildings now or hereafter situate upon said lands and take away the materials composing the same but it shall in each case before beginning said removing or tearing down execute and deliver to the

first party a bond of like effect with like surety and for like sum and conditioned, executed and delivered in like manner accordingly as any building to be removed or torn down is now situate on said land or is one hereafter erected thereon, provided, however, no building shall be removed or torn down after the year two thousand and ten, and no building shall be torn down or removed after this lease is forfeited cancelled or in any way terminated.

Fifth: At the time that the first party may recover or take possession of the said lands by reason of any suit wherein the judgment results in possession being taken of said lands by said first party, or at the time the said first [fol. 29] party may recover or take possession of the said lands on account of any breach of any agreements, covenants or stipulations herein contained, or at the time the terms of this lease may expire by lapse of time or otherwise terminate, then all buildings, fixtures, appliances and improvements placed upon the said lands, or any part or parts thereof, shall become, be and remain the property of the first party free of any claims, liens or incumbrances placed thereon by third party and the third party shall at all such times yield up the said buildings, fixtures, appliances and improvements into the possession of first party without any compensation therefor.

Sixth: In case the third party shall fail to pay the rents herein stipulated for at the place herein provided for at the time herein agreed upon, or if the third party shall fail to keep or perform any of the other covenants, agreements or stipulations in this lease contained and required to be kept and performed by it, then this lease may, at the option of the first party, be and become forfeited, null, void and of no effect and the term hereby created cease and terminate and the first party have the right to the possession of the said lands and all buildings and improvements, fixtures and appliances thereon and the same rights, privileges and remedies that he would have if the term herein created had expired by lapse of time instead of failure to pay rent or breach of any such covenants, agreements or stipulations, provided, however, that before declaring any [fol. 30] such forfeiture the first party shall give to the third party and to all such persons or parties as may have

acquired an interest in this lease by duly recorded assignments or conveyances, either as absolute conveyances or by way of security, and who shall have deposited for the first party at the place where the rent is at the time of depositing the notice hereafter mentioned payable a notice of the existence of their interest, written notice of their intention to declare such forfeiture, stating in such notice the cause of such forfeiture and setting forth, in case forfeiture is declared for failure to pay rent, that unless the rent is paid within thirty (30) days after the giving of such notice, or in case forfeiture is declared on account of breach of any other covenant, agreement or stipulation herein contained, that unless the covenant, stipulation or agreement claimed to have been broken is performed within thirty (30) days after the giving of such notice, that this lease will be declared forfeited; and if before the time set for declaring such forfeiture the said third party or some one for it shall pay the rent due or perform the agreement, covenant or stipulation claimed to have been broken, then the right of forfeiture shall not thereafter exist in so far as concerns the particular rent claimed in said notice not to have been paid or in so far as concerns the particular breach mentioned in said notice of any covenant, agreement or stipulation claimed to have been broken. In case notice is given of intention to declare forfeiture on account of the breach of any covenant, agreement or stipulation [fol. 31] contained in this lease other than the failure to pay rent it shall be considered a performance by the third party if it shall begin to perform such covenant, agreement or stipulation claimed to have been broken within thirty (30) days from the giving of such notice and prosecute to completion the work of performing such covenant, agreement or stipulation with all reasonable diligence. The right herein given to declare a forfeiture for non-payment of rent or for the breach of any covenant, stipulation or agreement contained in this lease shall not be construed as abrogating or waiving any rights or remedies for the recovery of lands or possession of the premises hereby leased given to or conferred on the first party by any present or future laws of any government or municipal authority, but the first party may declare the forfeiture or pursue his rights or remedies under any such laws or do both

at the same time. Each day of any continuing breach of any covenant, agreement or stipulation contained in this lease and agreed or required by the terms of this lease to be performed by the third party shall be a separate and distinct breach and no waiver of any breach or breaches of any such covenant, agreement or stipulation contained in this lease shall operate as a waiver of any subsequent breach of the same covenant, agreement or stipulation or of any other covenant, agreement or stipulation contained in this lease and by the terms of this lease required or agreed to be performed by the third party.

[fol. 32] Seventh: The third party shall not use or allow or permit to be used the said lands, or any part or parts thereof, or any buildings or improvements now or hereafter situate thereon, or any part or parts thereof, for any unlawful purpose, or in any manner now or hereafter forbidden by any law, ordinance or regulation of any country, state, government, municipality or governmental authority, and shall protect and save harmless the first party from all loss, cost, damage or expense caused or occasioned to him on account of any injury suffered by any person upon the said lands, buildings or improvements, or any part or parts thereof or upon any sidewalk, street or way on such lands or adjacent thereto.

Seventh: The first party may at all reasonable times enter upon and inspect the said lands, or any part or parts thereof and any buildings or improvements now or hereafter situate thereon, or any part or parts thereof.

Eighth: The third party shall indemnify the first party against and pay him all legal costs, charges, expenses and counsel fees lawfully and reasonably incurred in and about the premises in the defense of any suit brought to enforce any tax, assessment, charge, lien or incumbrance, or in obtaining possession after default by the third party or upon expiration of the term of this lease, provided any such suit is sustained and judgment in said suit rendered against first or third party.

[fol. 33] Ninth: The third party shall not, without the written consent of the first party convey, sell, assign, encumber, transfer, mortgage, pledge, convey by deed of trust or otherwise, or convey by any means or manner

whatever this lease, or any right or interest therein, unless the third party shall at such time have duly performed all agreements required or agreed by the terms of this lease to be performed by it before such time, but if at any time all agreements required or agreed by the terms of this lease to be theretofore performed by the third party have been duly performed, the third party shall then have the right to convey, sell, assign, incumber, transfer, mortgage, pledge, convey by deed of trust or otherwise, or convey by any means or manner whatever this lease, or any right or interest of third party therein without the consent of the first party. No assignment or transfer of this lease shall relieve the third party of any responsibility under the terms hereof unless the assignee shall in writing accept such assignment or transfer and agree to be bound by the terms of this lease nor unless the first party shall in writing consent to such assignment or transfer and any such assignment or transfer so made in writing and consented to by first party shall relieve third party from all obligations to thereafter perform any of the agreements required or agreed by the terms hereof to be kept by third party.

Tenth: All covenants, agreements and stipulations agreed and required by the terms of this lease to be kept [fol. 34] and performed by the third party or enforceable by it shall be construed as binding upon or enforceable by the successors of the third party by transfer or otherwise and upon or by any person or persons in any manner claiming by, through or under the third party and all covenants, agreements and stipulations herein contained and binding upon or enforceable by the first party shall be construed as binding upon and enforceable by all persons in any manner claiming by, through or under the said first party. The words "first party" as contained in this instrument shall unless qualified by other words be construed to mean not only the original first party as herein mentioned but all persons in any manner claiming by, through or under him and the words "third party" as contained in this instrument shall, unless qualified by other words, be construed to mean not only the original third party as herein mentioned but all its successors and all persons in any manner claiming by, through or under it, and unless expressly qualified by words of this instrument all

obligations of this instrument shall be binding upon and enforceable by all persons claiming by, through or under the first and third parties herein respectively in the same manner as if they had been specifically mentioned herein and bound hereby, but it being provided, however, that the provisions of this paragraph shall not bind any sub-tenants of the third party to perform any agreements, covenants or stipulations herein contained longer than the time any subletting to any such sub-tenants shall continue, nor in respect to any premises other than those sublet to [fol. 35] them.

Eleventh: If the third party erects any building or buildings on said land same shall be so constructed as not to depend for support upon any building on any adjacent or adjoining land. The said third party shall not be bound or obligated to construct or build any building on said land and does not contract with or obligate itself to either the first or second parties herein to construct or build any building on said land. If third party proceeds to construct or build any building on said land it must do so at its own cost and expense and third party shall not either acting for itself or as agent of first or second parties, or either of them, or in any capacity whatever have the right to nor is it authorized to bind or charge, or contract so as to bind or charge, the said land, or any part or parts thereof, with any lien, charge, encumbrance or mechanic's lien for the cost or expense, or any part of the cost or expense, of constructing or building any building on said land or for any work, labor or material done, performed or furnished upon, to or for any building on said land. In constructing or building any building on said land or in contracting for such building and construction the third party shall not have the right to and shall not in any manner represent or bind the first or second parties, or either of them, as their agent or in any capacity whatever.

Twelfth: It shall be the duty of all persons to whom notices are required or allowed by the terms hereof to be [fol. 36] given to keep the persons who may be required or allowed by the terms hereof to give such notices informed of their post office address and such information shall be given in writing by written instrument referring to this

lease addressed to Whom It May Concern and left at the place where the rent is payable. Any notice required or allowed to be given by the terms of this instrument shall be given to the persons to whom such notices are required or allowed to be given by being given to them personally if they live within the present limits of Jackson County, Missouri, and if by the exercise of reasonable diligence such notices can be given to them personally and such notices shall be deemed to be sufficiently given to any persons who do not live within the said limits of Jackson County, Missouri, or who do live within such limits and cannot by the exercise of reasonable diligence be given such notices personally, by mailing the same to them postage prepaid, to their last post office address, of which information shall be furnished as aforesaid, and by posting a copy of such notice in a conspicuous place on the premises hereby leased and by leaving a copy of such notice for them at the place where the rent is then payable, provided, however, that if any person entitled to receive any notice shall have failed to give information of its or his last post office address by written notice as herein required, then it shall not be necessary to mail to any such person any notice desired to be given. Such notices shall refer to this lease and be directed to Whom It May Concern and any notice shall be deemed sufficiently given if delivered personally [fol. 37] to the person entitled to receive the same no matter where delivered or if being mailed postage prepaid addressed to such person at any address shall be received by such person through the mails.

In case any person to whom a notice is allowed or required to be given by the terms hereof shall be a corporation, such notice may, if personally served, be given by delivery to any officer or any director of such corporation, or any person on the said leased premises in charge thereof for such corporation.

Thirteenth: The third party shall at all times at its own cost keep and put on all buildings and improvements now or hereafter situate on said lands all fixtures or appliances that may at any time be required by the laws, ordinances or regulations of any state, country, government or municipality within whose limits or jurisdiction said lands or any part or parts thereof are now or may hereafter be

situate, or by any governmental authority, and shall at all times keep all such fixtures and appliances in such condition as may be required by such laws, ordinances, regulations or governmental authority.

Fourteenth: In case the said lands or buildings or improvements now or hereafter situate thereon, or any part or parts thereof, shall be at any time during the continuance of the term of this lease taken, damaged or condemned by any public authority for any public use, the damages [fol. 38] shall, unless apportioned by the judgment, decree or proceeding allowing them, be apportioned between and among the first party and the third party in case of dispute by three disinterested persons, one chosen by the first party, one chosen by the third party and the third chosen by the two so chosen. The award of the majority of the persons so chosen shall be final. In case either party shall upon being requested by the other party fail to appoint the person so to be chosen by such party so requested, or in case the two persons so chosen fail to choose a third person then any damages shall be distributed among the parties according to their respective rights and equities by the decree of a court of competent jurisdiction.

Fifteenth: If this lease shall be by first party forfeited under the terms hereof then third party shall be bound to at once pay first party Thirty thousand Dollars ($30000.00) and if when this lease is so forfeited the third party shall pay first party said Thirty thousand Dollars ($30000.00) and deliver up and surrender to the first party the peaceable possession of the said lands, with all buildings, fixtures, improvements and appliances then thereon the third party shall be discharged of and from all liability of every kind under this lease, except that third party shall be bound to pay all rent that may have become due and payable before the time of such forfeiture and shall remain bound for the performance of all agreements herein contained that by the terms hereof should have been performed by third party before the time of such forfeiture [fol. 39] and this lease may at any time be cancelled by third party by giving first party written notice of such intention so to cancel the same and by paying to the first

party Thirty thousand Dollars ($30000.00) and by delivering up to the said first party peaceable possession of the said lands with all buildings, improvements, fixtures and appliances then thereon and upon so giving such written notice of such intention and also paying to said first party said sum of Thirty thousand Dollars ($30000.00) and also delivering to said first party such peaceable possession third party shall be discharged of and from all liability of every kind under this lease, except and provided, however, that the said third party shall not have the right to so cancel this lease unless at the time of such cancellation it shall have then paid all rents that are then due and payable under this lease and shall have then performed all agreements herein contained which by the terms hereof are to be performed by the third party before the time of such cancellation.

Sixteenth: If the time for doing any act required or allowed to be done by the terms hereof occurs on Sunday or any public holiday then such act may be done on the first succeeding day thereafter that is not a Sunday or a public holiday.

Seventeenth: At the expiration of the term of this lease either by lapse of time or by forfeiture or otherwise the third party will yield up to the first party the lands hereby leased, with all buildings, improvements, fixtures and [fol. 40] appliances situate thereon.

Eighteenth: Time is of the essence of this contract and when in any agreement, stipulation or condition contained herein any act is agreed to be done at any particular time or is forbidden to be done before any particular time then time is of the essence of any such agreement, stipulation or condition.

In Witness Whereof the said Charles A. Bruun and Myrtle M. Bruun, his wife, hereto set their hands and said Newmarket Investment Company causes these presents to be signed by W. G. Dickey, its President and its common and corporate seal to be hereunto af-

fixed, all on this first day of July, Nineteen hundred and fifteen. In duplicate.

(Seal) CHARLES A. BRUUN,
MYRTLE M. BRUUN,
NEWMARKET INVESTMENT COMPANY,
By W. G. Dickey, President.

Attest:
Geo. H. Davis,
Secy.

State of Missouri,
County of Jackson.—ss.:

On this 21st day of July, Nineteen hundred and fifteen, before me (a notary public in and for said County and State) personally appeared Charles A. Bruun and Myrtle M. Bruun, his wife, to me known to be the persons described in and who executed the foregoing instrument and acknowledged that they executed the same as their free act and deed.

[fol. 41] My commission expires, May 26, 1918.

In Witness Whereof I hereunto set my hand and affix my official seal the day and year first above written in this certificate.
(Seal)

CLARA E. HAYDEN,
Notary Public in and for said County and State.

State of Missouri,
County of Jackson.—ss.:

On this 29th day of July, Nineteen hundred and fifteen, before me (a notary public in and for said County and State) appeared W. G. Dickey, to me personally known, who being by me duly sworn, did say that he is the President of Newmarket Investment Company, and that the seal affixed to foregoing instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its board of directors and said W. G. Dickey acknowledged

said instrument to be the free act and deed of said corporation.

My commission expires Oct. 20, 1915.

Witness my hand and notarial seal the day and year first above written in this certificate.

(Seal)

E. J. FINLEY,
Notary Public in and for said County and State.

[fol. 42] (Memorandum Opinion of U. S. Board of Tax Appeals.)

United States Board of Tax Appeals.

Charles A. Bruun, Petitioner,
Docket No. 89454. vs.
Commissioner of Internal Revenue, Respondent.

L. E. Durham, Esq., for the petitioner.

W. W. Kerr, Esq., for the respondent.

Opper:—This proceeding involves an alleged deficiency in income tax for the year 1933 in the amount of $4,111.43.

The facts are found as stipulated by the parties.

Respondent's determination must be overruled on the authority of Louise C. Slack, 35 B. T. A. 271, and later cases to the same effect.

Decision will be entered for the petitioner.

Enter:

Entered Oct. 22, 1938.

Seal
U. S. Board of
Tax Appeals
1924

[fol. 43] (Order of Redetermination, October 22, 1938.)

United States Board of Tax Appeals,
Washington.

Charles A. Bruun, Petitioner,
Docket No. 89454. vs.
Commissioner of Internal Revenue, Respondent.

Decision.

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion entered October 22, 1938,

Ordered and Decided: That there is no deficiency in income tax for the year 1933.

Enter:

Entered Oct. 22, 1938.

Seal
U. S. Board of
Tax Appeals
1924

C. R. ARUNDELL,
Member.

[fol. 44] (Petition of Guy T. Helvering, Commissioner of Internal Revenue, for Review of Decision of United States Board of Tax Appeals.)

(Filed January 6, 1939, United States Board of Tax Appeals.)

In the United States Circuit Court of Appeals for the Eighth Circuit.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner on Review,
B. T. A. Docket No. 89454 vs.
Charles A. Bruun, Respondent on Review.

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Comes Now Guy T. Helvering, Commissioner of Internal Revenue by his attorney James W. Morris, Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Claude R. Marshall, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

Jurisdiction.

That the Petitioner on Review (hereinafter referred to as the Commissioner), is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United [fol. 45] States, appointed and holding his office by virtue of the laws of the United States; that Charles A. Bruun, the respondent on review (hereinafter sometimes referred to as the taxpayer) is an individual residing at Kansas City, Missouri; that the said Charles A. Bruun filed his Federal income tax return for the taxable year 1933 in the office of the Collector of Internal Revenue for the Sixth District of Missouri, located at Kansas City, Missouri, which said collection district is within the jurisdiction of the United States Circuit Court of Appeals for the Eighth Circuit.

The Commissioner seeks a review of the decision of the United States Board of Tax Appeals by virtue of the provisions of the Revenue Act of 1926, Sections 1001-1005, c. 27, 44 Stat. 9, as amended by the Revenue Act of 1928, Section 603, c. 852, 45 Stat. 873, and further amended by the Revenue Act of 1932, Section 1101, c. 209, 47 Stat. 169, and as further amended by the Revenue Act of 1934, Section 519, c. 277, 48 Stat. 680, and subsequent revenue acts.

II.

Nature of Controversy.

On March 17, 1937, the Commissioner in accordance with Section 272(a) of the Revenue Act of 1932, as amended by Section 501 of the Revenue Act of 1934, advised the respondent on review by registered mail that the determination of his income tax liability for the taxable year 1933, [fol. 46] disclosed a deficiency in tax of $4,111.43. Thereafter, on June 14, 1937, the respondent on review filed an appeal from said notice of deficiency with the United States Board of Tax Appeals. The Commissioner filed his answer to the petition on July 15, 1937. The case was heard on October 17, 1938; and on October 22, 1938, the Board of Tax Appeals entered its Memorandum Opinion for the taxpayer and on the same day October 22, 1938,

entered its decision ordering and deciding that there is no deficiency in income tax for the year 1933.

The case was submitted to the Board of Tax Appeals upon an agreed statement of facts. The Board adopted and found the facts as stipulated, which disclosed that between and including the first day of July, 1915 and the first day of July, 1933, the taxpayer owned real property in what is now Kansas City, Missouri, and that on July 1, 1915, he leased the said real property for a term of ninety-nine (99) years to the Newmarket Investment, a corporation, under a written indenture of lease. At the time of the execution of the lease there was a building upon said property and said building remained thereon until 1929, at which time it had an undepreciated cost to the taxpayer of $13,365.00. During 1929 the lessee demolished and removed said building from the premises and prior to December 31, 1929, it constructed a new building [fol. 47] upon said premises, which had a useful life of not more than fifty years. The lessee continued to occupy the premises and pay rent provided in said lease until March, 1933, when it defaulted in the payment of rent.

On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was cancelled and the property, together with the building thereon, was turned over to the taxpayer herein in accordance with the provisions of the aforesaid lease.

It is stipulated and agreed by the parties to this proceeding that as at said date, July 1, 1933, the building which had been erected upon the said premises by the lessee had a fair market value of $64,245.68 and that the unamortized cost of the old building, which was removed from the premises in 1929 to make way for the new building, was $12,811.43, thus leaving a net fair market value as at July 1, 1933, of $51,434.25, for the aforesaid new building erected upon the premises of the taxpayer by the lessee.

The taxpayer did not report any income in the year 1933 resulting from the cancellation of the above lease and the taking of possession by him of said property, including the building erected thereon, as provided by Article 63 of Regulations 77 (1932) as amended by Treasury Decision 4539, C. B. XIV-1, 141, approved April 10, 1935.

[fol. 48] In auditing the taxpayer's return, the Commissioner determined that as a result of the aforementioned transaction the taxpayer realized a net gain of $51,434.25, being the difference between $64,245.68, the aforesaid value on July 1, 1933, of the building erected upon said premises by the lessee, and $12,811.43, the adjusted cost base of the building demolished and removed from the premises by the lessee in 1929.

The Board of Tax Appeals, upon the authority of Louise C. Slack, (1-19-37), 35 B. T. A. 271, and later cases decided by it, determined and held that no income was realized by the taxpayer in the year 1933, when the lease was cancelled and the property was repossessed by the taxpayer.

The Board's decision is contra and overrides the regulations promulgated by the Commissioner under the provisions of the Revenue Act of 1932, to-wit: Article 63 of Regulations 77, as amended by Treasury Decision 4539 (C. B. XIV-1, 141) approved April 10, 1935, which provide, in part, that where improvements are erected on leased land, which improvements have a life less than that of the leasehold, that in the event of the termination of the leasehold prior to the expiration of the life of the improvements the depreciated value of such improvements as at date of termination of the leashold constitutes taxable income.

[fol. 49] The sole issue involved is—whether a lessor derived taxable income in the year of the cancellation and surrender of a 99-year lease of real property to the extent of the then depreciated value of a building constructed thereon by the lessee under the terms of the lease.

III.

Assignments of Error

That the Commissioner of Internal Revenue being aggrieved by the opinion and decision of the United States Board of Tax Appeals in this proceeding, hereby petitions for a review of said opinion and decision by the United States Circuit Court of Appeals for the Eighth Circuit, and for the correction of the manifest errors which therein occurred and intervened to his prejudice. The errors committed by the Board, which are relied upon by the Com-

missioner as the basis for this petition for review, are as follows:

1. The Board of Tax Appeals erred in holding and deciding that no taxable income resulted to the taxpayer, lessor, in the year 1933, upon the termination of a 99-year lease by cancellation and his acquisition of the property including a building with an undepreciated value, erected thereon by lessee.

2. The Board of Tax Appeals erred in not holding and deciding that the taxpayer, lessor, realized taxable income in the amount of $51,434.25 during the year 1933, by rea- [fol. 50] son of the termination of a 99-year lease by cancellation and his acquisition of possession of the property, including a building erected thereon by lessee.

3. The Board of Tax Appeals erred in holding and deciding upon the authority of its decision in the case of Louise C. Slack (35 B. T. A. 271) that the taxpayer realized no taxable income in the year 1933 by reason of the termination of a 99-year lease by cancellation and his acquisition of the land including a building erected thereon by the lessee.

4. The Board of Tax Appeals erred in that its conclusions of law are without substantial evidence to support them.

5. The Board of Tax Appeals erred in entering its decision that there is no deficiency in income tax for the year 1933.

6. The Board of Tax Appeals erred in failing and refusing to enter its decision that there is due from the taxpayer a deficiency in income tax for the year 1933 in the amount of $4,111.43.

Wherefore, the Commissioner petitions that said findings of fact and opinion and decision of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit; that a transcript of the record be prepared in accordance with the law and the rules of said court and be transmitted to the Clerk of said court for filing and that appropriate

[fol. 51] action be taken to the end that the errors complained of may be reviewed and corrected by said court.

JAMES W. MORRIS,
Assistant Attorney General.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

Claude R. Marshall,
Special Attorney,
Bureau of Internal Revenue.

k 11-17-38

[fol. 52] United States of America,
District of Columbia.—ss.:

Claude R. Marshall, being duly sworn, says that he is a Special Attorney in the Bureau of Inter al Revenue and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

CLAUDE R. MARSHALL,
Special Attorney,
Bureau of Internal Revenue.

Sworn and subscribed to before me this 5th day of January, 1939.

GEORGE W. KREIS,
Notary Public.

My commission expires Nov. 15, 1942.

[fol. 53] (Notice of Filing of Petition for Review and Acknowledgment of Service by Respondent on Review.)

(Filed January 18, 1939, United States Board of Tax Appeals.)

To: Charles A. Bruun, Esq., 8619 Holmes Street, Kansas City, Missouri.

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of January, 1939, file

with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 6th day of January, 1939.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 13 day of January, 1939.

CHARLES A. BRUUN,
Respondent on Review.

[fol. 54] (Notice of Filing of Petition for Review and Acknowledgment of Service by William J. Carroll, Counsel for Respondent on Review.)

(Filed January 18, 1939, United States Board of Tax Appeals.)

To: William J. Carroll, Esq., 901 National Fidelity Life Bldg., Kansas City, Missouri.

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of January, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 6th day of January, 1939.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 12 day of January, 1939.

WILLIAM J. CARROLL,
Attorney for Respondent on Review.

[fol. 55] (Notice of Filing of Petition for Review and Acknowledgment of Service by L. E. Durham, Counsel for Respondent on Review.)

(Filed January 18, 1939, United States Board of Tax Appeals.)

To: L. E. Durham, Esq., 201 First National Bank Bldg., Kansas City, Missouri.

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of January, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 6th day of January, 1939.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 13 day of January, 1939.

L. E. DURHAM,
Attorney for Respondent on Review.

[fol. 56] (Notice of Filing of Petition for Review and Acknowledgment of Service by John H. McEvers, Counsel for Respondent on Review.)

(Filed January 18, 1939, United States Board of Tax Appeals.)

To: John H. McEvers, Esq., c/o Ryland, Stimson, Mag & Thomson, First National Bank Building, Kansas City, Missouri.

You are hereby notified that the Commissioner of Internal Revenue did, on the 6th day of January, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 6th day of January, 1939.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 12 day of January, 1939.

JOHN H. McEVERS,
Attorney for Respondent on Review.

[fol. 57] (Praecipe For Transcript.)

(Filed January 30, 1939, United States Board of Tax Appeals.)

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the

said Circuit Court of Appeals for the Eighth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.

2. Pleadings before the Board.

(a) Petition, including annexed copy of deficiency letter and statement attached thereto.

(b) Answer.

3. Memorandum Opinion entered October 22, 1938.

4. Decision entered October 22, 1938.

5. Stipulation of Facts with Exhibit "A" attached.

6. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review:

[fol. 58] 7. Any and all orders of enlargement made by the Board with respect to the preparation and transmission of the record on review, not included in record.

8. This praecipe.

Said transcript to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Eighth Circuit.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this day of , 1939.

Attorney for Respondent on Review.

[fol. 59] (Clerk's Certificate to Transcript.)

United States Board of Tax Appeals,
Washington.

Commissioner of Internal Revenue, Petitioner,
Docket No. 89454. vs.
Charles A. Bruun, Respondent.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 58, inclu-

sive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 11th day of February, 1939.

Seal
U. S. Board of
Tax Appeals
1924

B. D. GAMBLE,
Clerk, United States Board
of Tax Appeals.

Filed Feb. 15, 1939. E. E. Koch, Clerk.

Order of submission

May Term, 1939

Monday, May 22, 1939

This cause having been called for hearing in its regular order, argument was commenced by Mr. Oliver W. Hammonds, Special Assistant to the Attorney General, for petitioner, continued by Mr. John H. McEvers, for respondent, and concluded by Mr. Oliver W. Hammonds, Special Assistant to the Attorney General, for petitioner.

Thereupon, this cause was submitted to the Court on the transcript of the record from said Board of Tax Appeals and the briefs of counsel filed herein, with leave to petitioner to furnish additional authorities.

Opinion

United States Circuit Court of Appeals, Eighth Circuit

No. 11429—May Term, A. D. 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES A. BRUUN, RESPONDENT

On Petition to Review Decision of United States Board of Tax Appeals

[July 20, 1939]

Mr. Oliver W. Hammonds, Special Assistant to the Attorney General (Mr. Sewall Key, Mr. J. Louis Monarch, and Mr. Edward M. English, Special Assistants to the Attorney General, on the brief) for petitioner.

Mr. John H. McEvers (Mr. Reece A. Gardner and Messrs. Ryland, Stinson, Mag & Thomson were with him on the brief) for respondent.

Before GARDNER and THOMAS, Circuit Judges, and WYMAN, District Judge.

THOMAS, Circuit Judge, delivered the opinion of the court.

The petition of the Commissioner of Internal Revenue for review of a decision of the United States Board of Tax Appeals involves an alleged deficiency of income tax of Charles A. Brunn for the year 1938 in the amount of $4,111.43.

The facts were found by the Board as stipulated by the parties. The opinion is a memorandum opinion and not officially reported.

The respondent Bruun is a resident of Kansas City, Missouri. At all times material to the question presented he owned a lot located in that city. On July 15, 1915, under a written indenture he leased the lot for a term of 99 years to New Market Investment

Company, a corporation. When the lease was executed a building stood upon the lot. It remained there until 1929. During that year the lessee removed the old building and constructed a new one upon the premises, which had a useful life of not more than fifty years. On July 1, 1933, the lessee defaulted in the payment of rent, the lease was cancelled, and the lot, together with the building thereon, was turned over to the respondent taxpayer.

On July 1, 1933, when the lease was cancelled, the building erected on the premises by the lessee had a fair market value of $64,245.68 and the unamortized cost of the building removed by the lessee in 1929 was $12,811.43, leaving a net fair market value of the new building of $51,434.25 as of July 1, 1933, the date on which the lease was cancelled.

The taxpayer in his income-tax return for 1933 did not report any income resulting to him by reason of the cancellation of the lease. The Commissioner determined that as a result of the transaction he sustained a net gain of $51,434.25 and determined a deficiency of $4,111.43.

Had the lease not been cancelled it would have expired by its terms in 2014. It provided for forfeiture for nonpayment of rent, authorized the removal of the building on the premises at the date of its execution, and permitted but did not require the construction of a new building by the lessee. The lease provided that upon conditions not now material the lessee could remove the building erected by it at any time until four and one-half years prior to the expiration of the lease. It also provided that in case of forfeiture of the lease or upon its termination the premises should be surrendered with all buildings and improvements thereon.

The question presented is whether the respondent derived any taxable income in the year 1933 by reason of the cancellation of the lease and the surrender of the demised premises by the lessee.

The Commissioner contends that the net value of the building on July 1, 1933, erected by the lessee in the amount of $51,434.25 was taxable under section 22 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169. The pertinent part of the statute reads:

"Gross income includes gains, profits, and income derived from * * * commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * * and income derived from any source whatever * * *."

It is the contention of the Commissioner that the net value of the building erected by the lessee was definitely realized when the lease was canceled in 1933, and is taxable income to the lessor for that year. The taxpayer contends that only an increase in the value of the real estate resulted from the transaction, and that there could be no realized gain to the lessor prior to the sale of the premises. It is settled that the income tax laws are concerned only with realized gains. Lucas *v.* American Code Co., 280 U. S.

445. The government seeks to distinguish this case from the decision of the Supreme Court in Eisner *v.* Macomber, 252 U. S. 189, in which it was held that appreciation in the value of property is merely an addition to capital and not constitutionally taxable as income until severed.

We are not here interested in whether or not the Commissioner correctly determined the fair market value of the building at the time the lease was canceled in 1933, or the amount of the gain, if any. The parties stipulated at the hearing before the Board that the net fair market value of the building as at July 1, 1933, was $51,434.25; and that

"If the Commissioner of Internal Revenue properly included in the gross income of the petitioner for 1933 the fair market value as of that time of the building constructed upon said premises by the lessee, the deficiency herein is $4,111.43. On the other hand, if his action in including the fair market value of said building in income of the petitioner was erroneous, there is no deficiency in tax."

The parties do not agree as to when the title to the building vested in the lessor. It is the general rule that whether the title to an improvement placed upon leased premises by the lessee vests in the lessor or remains in the lessee is a question of intent to be determined by the language used in the written lease. Armstrong Cork Co. v. Merchants' Refrigerating Co., 8 Cir., 184 F. 199, 209. The lease in the instant case clearly reserved the title in the lessee with right to remove the building upon certain conditions until the last 4 and one-half years of the term; but it further provided that "At the expiration of the term of this lease either by lapse of time or by forfeiture or otherwise the third party (lessee) will yield up to the first party (lessor) the lands hereby leased, with all buildings * * * thereon." The title to the building, therefore, vested in the taxpayer July 1, 1933, when the lease was cancelled and not before.

In the case of Miller v. Gearin, 9 Cir., 258 F. 225, the essential facts were the same as the facts in the present case, except that the lease provided that the ownership of all buildings put upon the premises by the lessee was to vest in the lessor immediately upon the construction of the same. The court said that "Assuming that the building was income derived from the use of the property, we think it clear that the time when it was 'derived' was the time when the completed building was added to the real estate and enhanced its value."

In the case of Hewitt Realty Co. v. Commissioner, 2 Cir., 76 F. (2d) 880, the question presented was whether a part of the value added to the taxpayer's premises by the construction of a building thereon by the tenant in 1931 was taxable income for that year. The majority of the court held that the added value was not taxable income in 1931 because it was not "something separately disposable"; and that such added value would be income in the con-

stitutional sense "only when the land is sold, and then only insofar as it increases 'amount realized' at that time."

In the case of M. E. Blatt Co. v. United States, 305 U. S. 267, 279, in which the Commissioner added to the income of a taxpayer on account of improvements made to its property by a lessee, the court said: "Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor." The court then stated the test to be applied thus: "So far as concerns taxable income, the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute. In this connection the Hewitt Realty Co. case was cited with implied approval.

Under this rule the taxpayer in the present case is in the same position with respect to income that he would have been had he constructed a building upon his premises in 1933 worth $51,434.25 in excess of cost. Such a building would have added "enhanced" or "excess" value to the real estate in that year; but it would have been only "an addition to capital; not income."

While in the cited cases the title to the improvements placed upon the leased premises by the lessee vested in the lessor under the terms of the lease at the time the improvements were made, whereas in the instant case title did not vest until the lease was terminated in a subsequent year, the principle is the same in all of them. The rule stated by the Supreme Court in the Blatt case, supra, is controlling. No income was realized by the respondent in 1933 by reason of the cancellation of the lease.

Affirmed.

United States Circuit Court of Appeals, Eighth Circuit

No. 11429

May Term, 1939

Monday, July 24, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CHARLES A. BRUUN

On Petition to Review Decision of United States Board of Tax Appeals

This cause came on to be heard on the petition of the Commissioner of Internal Revenue for a review of a decision of the United States Board of Tax Appeals involving an alleged deficiency of income tax of the respondent, Charles A. Bruun, for the year 1933, in the amount of $4,111.43, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and reed by this Court that the decision of the said Board of Tax peals in this cause be, and the same is hereby, affirmed.
And it is further ordered by this Court that the petition to review this cause be, and the same is hereby, dismissed without the tax-on of costs in favor of either of the parties in this Court.
TLY 24, 1939.

United States Circuit Court of Appeals, Eighth Circuit

. E. E. Koch, Clerk of the United States Circuit Court of Appeals the Eighth Circuit, do hereby certify that the foregoing contains record on petition to review the decision of the United States ard of Tax Appeals as prepared and printed under the rules of United States Circuit Court of Appeals for the Eighth Circuit, der the supervision of its Clerk, and full, true, and complete ies of all the pleadings, record entries, and proceedings, including opinion had and filed in the United States Circuit Court of peals, except the full captions, titles, and endorsements omitted oursuance of the rules of the Supreme Court of the United States, a certain cause in said Circuit Court of Appeals wherein Guy T. lvering, Commissioner of Internal Revenue, was Petitioner, and arles A. Bruun was Respondent, No. 11429, as full, true, and com-te as the originals of the same remain on file and of record in office.

do further certify that on the seventh day of September A. D. 9, a mandate was issued out of said Circuit Court of Appeals ected to the United States Board of Tax Appeals in said cause.

n testimony whereof, I hereunto subscribe my name and affix seal of the United States Circuit Court of Appeals for the ghth Circuit, at office in the City of St. Louis, Missouri, this third of October A. D. 1939.

SEAL]

E. E. KOCH,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

U. S. GOVERNMENT PRINTING OFFICE 1939

Supreme Court of the United States

Order allowing certiorari

Filed November 22, 1939

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

U. S. GOVERNMENT PRINTING OFFICE 19-0

No. 479

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, Commissioner of Internal Revenue, PETITIONER

v.

CHARLES A. BRUUN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1939

No. ——

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES A. BRUUN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Eighth Circuit, entered in the above-entitled cause on July 24, 1939, affirming a decision of the Board of Tax Appeals.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 30) is unreported. The opinion of the Circuit Court of Appeals (R. 43–46) is reported at 105 F. (2d) 442.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 24, 1939. (R. 47.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a lessor derives income in the year of the cancellation of a lease to the extent of the then value of a building erected by the lessee and forfeited to the lessor upon the termination of the lease because of its breach.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

ART. 63 [as amended by T. D. 4539, XIV–1 Cum. Bull. 141 (1935)]. *Improvements by lessees.*—If buildings are erected or improvements made by a lessee and such buildings or improvements immediately become the property of the lessor, as, for instance, if they are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(*a*) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease.

(*b*) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the expiration of the lease and report as income for each year of the lease an aliquot part thereof.

If the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor shall report income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he becomes entitled to such possession exceeds the amount already reported as income on

account of the erection of such buildings or improvements. No appreciation in value due to causes other than the termination of the lease shall be included.

* * * * * *

STATEMENT

The facts were stipulated (R. 13–30) and they may be summarized as follows:

The taxpayer, at all times material here, owned a lot located in Kansas City, Missouri. On July 1, 1915, he leased the lot for a term of 99 years to the Newmarket Investment Company. At the time of the execution of the lease there was a building upon the property which had an undepreciated cost to the taxpayer of $13,365. During the year 1929 the lessee, as it was permitted to do under the lease, demolished and removed the building from the premises and during that same year it constructed a new building, which had a useful life of not more than fifty years. (R. 14.)

On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was cancelled and the property, together with the buildings then thereon, turned over to the taxpayer. On that date the building which had been erected by the lessee had a fair market value of $64,245.68 and the unamortized cost of the old building removed by the lessee in 1929 was $12,811.43, leaving an excess of $51,434.25 in the fair market value of the new building as of July 1, 1933, the date the lease was cancelled. (R. 14.)

The Commissioner of Internal Revenue determined that the taxpayer, as a result of the termination of the lease, realized a net gain of $51,434.25, being the difference between $64,245.68, the value of the new building, and $12,811.43, the adjusted cost base of the old building. (R. 15.) The Board of Tax Appeals held that no gain was realized in 1933 (R. 30), and the Circuit Court of Appeals affirmed (R. 46).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that no taxable income resulted to the taxpayer in the year 1933 upon the premature termination of the lease, and his acquisition of the property including a building erected thereon by the lessee.

2. In failing to hold that the taxpayer realized a net taxable income in the amount of $51,434.25 during the year 1933 by reason of the termination of the lease by cancellation and his acquisition of possession of the property including the building erected thereon by the lessee.

3. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. This case presents an important question in the administration of the federal income tax laws which is sorely in need of a clear and authoritative answer. For over twenty years the Treasury

has wrestled with the problem of how to tax the admitted gain which accrues to a lessor as a result of improvements added or buildings constructed by the lessee, and its task has been made a most difficult one by conflicting and uncertain judicial decision.

At an early date the Treasury took the position that improvements made by the lessee constituted taxable income to the lessor upon termination of the lease.[1] However, in 1919, the Circuit Court of Appeals for the Ninth Circuit held invalid the regulations which embodied that rule. *Miller* v. *Gearin,* 258 Fed. 225. The court said that the gain represented by the new building constructed by the lessee, if taxable at all, must be treated as having been realized when the building was first completed (p. 226). The Government sought further review, but this Court denied certiorari. 250 U. S. 667.

The Treasury thereupon undertook to accommodate itself to the court's decision. It amended its practice, and ruled that income was realized when the improvements were added in the amount

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[1] See Mimeographed Decision 2714, 4 Cumulative Bulletin 90, for a discussion of the history of the early rulings on this issue.

T. D. 2442, which set forth the practice, was promulgated on February 6, 1917, and was later embodied, with minor changes, in the revised edition of Regulations 33 (1916 Act), Article 4, paragraph 50, and in Regulations 45 (1918 Act), Article 48.

of their fair market value subject to the lease.[2] Provision was also made for imposing an additional tax at the premature termination of the lease to the extent that the value of the improvements upon such termination should exceed the income originally reported, subject to the condition, however, that such excess should not include any appreciation in value due to causes other than premature termination.

But it was held in 1935 that the new regulations were invalid. *Hewitt Realty Co.* v. *Commissioner*, 76 F. (2d) 880 (C. C. A. 2d). And a case finally reached this Court in which the Government hoped that the issue would be definitively disposed of. *M. E. Blatt Co.* v. *United States*, 305 U. S. 267. However, that decision appears to turn largely upon the facts there presented, and the Government strongly feels the need of a clear-cut adjudication on this question to dispel the existing confusion.

---

[2] The new ruling appeared as T. D. 3062, 3 Cumulative Bulletin 109, 144, 171. This ruling was thereafter embodied in the 1920 edition of Regulations 45, Article 48.

Regulations 62, Article 48, promulgated under the Revenue Act of 1921, continued these provisions, and, as a concession to taxpayers, gave the lessor the option of reporting the depreciated value of the improvements either in full during the year they were added or to spread that amount over the life of the lease, reporting an aliquot part each year. These provisions thereafter reappeared from time to time with certain modifications and enlargements in the various regulations issued under the succeeding Revenue Acts. See Regulations 65 (1924 Act), Article 48; Regulations 69 (1926 Act), Article 48; Regulations 74 (1928 Act), Article

The question here involved has recurred under all the Revenue Acts and is presented in at least several cases now pending in the lower courts or before the Board of Tax Appeals.

2. The decision below is a misapplication of *M. E. Blatt Co.* v. *United States*, 305 U. S. 267. There the lease was still in effect, and while the owner's property had been improved without expense to it, the lessee was presently in possession. This Court held (p. 280) that the owner "had no right to use or dispose of them [the improvements] during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute."

The situation in the instant case is different. Here the lease has been forfeited and the respondent has come into full possession and enjoyment of the improvements, released from the rights previously held by the lessee. In this case there is not merely an enhancement in value, but an income-producing event has occurred of the character which, in comparable situations, has been held to result in taxable income. Thus, the release from a liability is equivalent to the receipt of income. *United States* v. *Kirby Lumber Co.*, 284 U. S. 1; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342; *United States* v. *Hendler*, 303 U. S.

63; Regulations 77 (1932 Act), Article 63; Regulations 86 (1934 Act), Article 22 (a)–13; Regulations 94 (1936 Act), Article 22 (a)–13; Regulations 101 (1938 Act), Article 22 (a)–13.

564, 566. Such cases support the Government's contention here that the acquisition by the respondent of the unrestricted right to use the new improvements supplies the element which was missing in the *Blatt* case. We therefore submit that the court below has made an unwarranted application of the *Blatt* decision. That decision has been similarly misapplied in *Nicholas* v. *Fifteenth Street Inv. Co.*, 105 F. (2d) 289 (C. C. A. 10th) and *Cleveland Trust Co., Trustee* v. *Commissioner*, 39 B. T. A. 113, which emphasize the need for an authoritative decision on this question.

3. In the broad sweep of its definition of gross income in Section 22 (a), *supra*, p. 2, Congress intended to make that definition co-extensive with its power under the Constitution. *Helvering* v. *Stockholms &c. Bank*, 293 U. S. 84, 89; *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 89; *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 233; *Irwin* v. *Gavit*, 268 U. S. 161, 166. The decision of the court below, therefore, really amounts to a holding that Congress is forbidden by the Constitution to tax the lessor with respect to the improvements added: that there has been no "realization" of income in the constitutional sense. Cf. *Eisner* v. *Macomber*, 252 U. S. 189. And in the *Hewitt Realty Co.* case, *supra*, the majority opinion made it quite clear that the question was one of constitutional power (p. 884).

To say that an owner of property has not realized anything when he comes into possession and finds a new building thereon is, we submit, to fly in the face of plain fact. It is difficult to believe that the Constitution was ever intended thus to circumscribe the power of Congress. For, it is firmly established that income may be received in the form of property and it seems impossible to imagine that the Constitution requires a distinction to be drawn between property affixed to the realty and property that is merely deposited thereon.

In view of the seriousness of the issue thus presented, it is important that this case be brought before this Court for further review.

CONCLUSION

For the foregoing reasons it is respectfully submitted that this petition should be granted.

ROBERT H. JACKSON,
Solicitor General.

OCTOBER, 1939.

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FILE COPY

No. 479

In the Supreme Court of the United States

OCTOBER TERM, 1939

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CHARLES A. BRUUN

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 30) is unreported. The opinion of the Circuit Court of Appeals (R. 43–46) is reported at 105 F. (2d) 442.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 24, 1939 (R. 46–47). The petition for a writ of certiorari was filed October 21, 1939, and was granted November 22, 1939. The jurisdiction of this Court is conferred by Section

240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a lessor derives income in the year of the cancellation of a lease to the extent of the then value of a building erected by the lessee and forfeited to the lessor upon the termination of the lease because of its breach.

STATUTE AND REGULATIONS INVOLVED

The relevant statute and regulations are set out in the Appendix, *infra*, pp. 27–30.

STATEMENT

The facts were stipulated (R. 13–30) and they may be summarized as follows.

The taxpayer, at all times material here, owned a lot in Kansas City, Missouri. On July 1, 1915, he leased the lot for a term of 99 years to the Newmarket Investment Company. At the time of the execution of the lease there was a building upon the property which had an undepreciated cost to the taxpayer of $13,365. During the year 1929 the lessee, as it was permitted to do under the lease, demolished and removed the building from the premises and during that same year it constructed a new building, which had a useful life of not more than fifty years (R. 14).

On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was

cancelled and the property, together with the buildings then thereon, turned over to the taxpayer. On that date the building which had been erected by the lessee had a fair market value of $64,245.68 and the unamortized cost of the old building removed by the lessee in 1929 was $12,811.43, leaving an excess of $51,434.25 in the fair market value of the new building as of July 1, 1933, the date the lease was cancelled (R. 14).

The Commissioner of Internal Revenue determined that the taxpayer, as a result of the termination of the lease, realized a net gain of $51,434.25, being the difference between $64,245.68, the value of the new building, and $12,811.43, the adjusted cost base of the old building (R. 15). The Board of Tax Appeals held that no gain was realized in 1933 (R. 30), and the Circuit Court of Appeals affirmed (R. 46).

SPECIFICATION OF ERRORS TO BE URGED.

The Circuit Court of Appeals erred:

1. In holding that no taxable income resulted to the taxpayer in the year 1933 upon the premature termination of the lease, and his acquisition of the property including a building erected thereon by the lessee.

2. In failing to hold that the taxpayer realized a net taxable income in the amount of $51,434.25 during the year 1933 by reason of the termination of the lease by cancellation and his acquisition of

possession of the property including the building erected thereon by the lessee.

3. In affirming the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

I

The problem of how to tax the admitted gain which accrues to a lessor as a result of improvements made by the lessee has had a long administrative and judicial history. In 1917 the Treasury ruled that the improvements constitute income to the lessor upon termination of the lease, after deducting a reasonable amount for depreciation, etc. That ruling was incorporated in the two succeeding editions of the Treasury Regulations. Thereafter, it was held in *Miller* v. *Gearin,* 258 Fed. 225 (C. C. A. 9th), that the rule so embodied in the regulations was invalid. The court said that the gain, if taxable at all, must be reported when the improvements were first completed and title passed to the lessor. This Court denied certiorari, 250 U. S. 667.

The Treasury Department thereupon amended its regulations to conform to that decision. Under the new practice, a tax was imposed upon the gain in the year the improvements were completed, measured by their anticipated value at termination of the lease and discounted for the term of the lease. The lessor was later given the option of spreading the depreciated value of the improvements over the

remaining life of the lease, reporting an aliquot part each year, and, upon premature termination, provision was made for the imposition of a tax upon the excess of the then value of the improvements over the amount theretofore reported.

Subsequently, after a lapse of about fifteen years, the new regulations were declared invalid in *Hewitt Realty Co.* v. *Commissioner,* 76 F. (2d) 880 (C. C. A. 2d), and in *M. E. Blatt Co.* v. *United States,* 305 U. S. 267, as applied to a tax for a year prior to termination of the lease. The Court in the *Blatt* case stated (p. 280) that the lessor "had no right to use or dispose" of the improvements during the term of the lease, and that "Mere acquisition of that sort did not amount to contemporaneous realization of gain." The Court left open the question here presented, namely, whether taxable gain is realized upon termination of the lease, when the lessor comes into unfettered possession of a new and valuable asset.

II

It is the Government's position that the gain here in question comes within the broad sweep of the all-inclusive definition of gross income contained in Section 22 (a) of the Revenue Act of 1932. That definition is coextensive with the power of Congress under the Constitution, and the tax can be invalid only if it exceeds a constitutional limitation.

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It seems plain that there can be no constitutional objection to the tax here involved. *Eisner* v. *Macomber*, 252 U. S. 189, held that income must be "realized" to be taxable, and that common stock dividends paid on common stock are not income because the stockholder has not "received" anything. Here, however, the lessor has received something new. He has come into possession of a substantial and valuable building. It would be sheer sophistry to assert that he has not acquired something new and valuable. The decisions of this Court, both before and after *Eisner* v. *Macomber*, make it clear that income may be received in the form of property. And it is immaterial that the gain is affixed to the taxpayer's preexisting capital. In the case of exchanges of property, taxable income may unquestionably be realized, even though the gain is inextricably bound up in the property received in exchange. Subsequent resale has never been deemed necessary in order to impose the tax under those circumstances, and it should be no more essential here.

ARGUMENT

I

INTRODUCTORY—THE PROBLEM AND ITS HISTORY

The problem of how to tax the admitted gain which accrues to a lessor as a result of improvements made by the lessee has long been a troublesome one. On February 6, 1917, the Treasury ruled that the improvements constituted income to

the lessor upon termination of the lease. T. D. 2442, 19 Treas. Dec. Int. Rev. 25.[1] The amount taxable was not the full cost of the improvements, but rather that amount less a reasonable allowance for depreciation, etc. This ruling was then incorporated, with some modification not material here, in the 1918 edition of Regulations 33, Article 4, par. 50, and in the 1919 edition of Regulations 45, Article 48.

Shortly thereafter, the Circuit Court of Appeals for the Ninth Circuit held those regulations invalid. *Miller* v. *Gearin*, 258 Fed. 225. The court said that the lessor realized no taxable income upon termination of the lease, and that the gain represented by the new building, if taxable at all, must be taxed when the building was first completed and title passed to the lessor (p. 226). This Court denied the Government's petition for certiorari. 250 U. S. 667.

The Treasury Department thereupon undertook to accommodate itself to that decision. It amended its practice, and ruled that income was realized in the year the improvements were added, taxable in the amount of their fair market value subject to the lease. T. D. 3062, 3 Cumulative Bulletin 109, later embodied in the 1920 edition

[1] Prior to this Treasury Decision there had been in effect a somewhat ambiguous ruling that amounts so expended by the lessee were taxable to the lessor in the year in which the benefits "accrued to the landlord." T. D. 2135, 17 Treas. Dec. Int. Rev. 39, 44–45, issued January 23, 1915.

of Regulations 45, Article 48. The new ruling also made provision for the imposition of an additional tax at the premature termination of the lease to the extent that the value of the improvements at such termination should exceed the income originally reported, subject to the condition, however, that such excess should not include any appreciation in value due to causes other than premature termination.[2]

The new ruling occasioned by *Miller* v. *Gearin* was continued and amplified in the regulations promulgated under the Revenue Act of 1921. Article 48 of Regulations 62 (1921 Act) gave the lessor the option of reporting the value of the improvements subject to the lease in full when they were added, or to spread the depreciated value of the improvements over the life of the lease, reporting an aliquot part each year. And these provisions thereafter reappeared from time to time with various modifications and enlargements in the regulations issued under the succeeding revenue acts.[3]

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[2] The fact that the change in practice was made in response to judicial decision is fully explained in Mim. 2714, 4 Cumulative Bulletin 90. In accord with *Miller* v. *Gearin*, at that time was *Cryan* v. *Wardell*, 263 Fed. 248 (N. D. Cal.).

[3] Regulations 65 (1924 Act), Article 48; Regulations 69 (1926 Act), Article 48; Regulations 74 (1928 Act), Article 63, as amended by T. D. 4539, XIV–1 Cumulative Bulletin 141; Regulations 77 (1932 Act), Article 63, as amended by T. D. 4539, XIV–1 Cumulative Bulletin 141; Regulations 86 (1934 Act), Article 22 (a)–13; Regulations 94 (1936 Act), Article 22 (a)–13; Regulations 101 (1938 Act), Article 22 (a)–13.

The new practice, initiated after *Miller* v. *Gearin*, continued without any serious challenge for about fifteen years[4] until 1935 when the Circuit Court of Appeals for the Second Circuit declared the new regulations invalid, and struck down a tax for a year prior to the termination of the lease. *Hewitt Realty Co.* v. *Commissioner*, 76 F. (2d) 880.

Thereafter, during the 1938 term of this Court, it was held that the lessor could not be taxed upon improvements made by the lessee where the lease had not yet expired, *M. E. Blatt Co.* v. *United States*, 305 U. S. 267, thus likewise invalidating the regulations which had been adopted to reflect the result reached in *Miller* v. *Gearin*. The Court said (p. 280):

> It may be assumed that, subject to the lease, lessor became owner of the improvements at the time they were made. But it had no right to use or dispose of them during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute.

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[4] The issue was not raised very often, but whenever the occasion presented itself the new practice was always mentioned with approval. *United States* v. *Boston & Providence R. R. Corp.*, 37 F. (2d) 670, 672 (C. C. A. 1st); *Crane* v. *Commissioner*, 68 F. (2d) 640, 641 (C. C. A. 1st); *Kentucky Block Coal Co.* v. *Lucas*, 4 F. Supp. 266, 268 (W. D. Ky.); *Brown* v. *Commissioner*, 4 B. T. A. 1129; *Crosby* v. *Commissioner*, 4 B. T. A. 1147; *Scott* v. *Commissioner*, 9 B. T. A. 1219; *Alexander* v. *Commissioner*, 13 B. T. A. 1169; *Cataract Ice Co.* v. *Commissioner*, 23 B. T. A. 654; *Martin* v. *Commissioner*, 24 B. T. A. 813.

It refused to state whether improvements made by a lessee could constitute income to the lessor upon termination or at any other time (p. 276).[5]

The *Blatt* case thus left open the question, previously decided against the Government in *Miller* v. *Gearin*, whether the lessor realizes taxable income at the termination of a lease when he comes into possession of a valuable building constructed by the lessee. The court below in the instant case therefore erred in invoking the *Blatt* case as controlling here (R. 46). And in *Commissioner* v. *Wood*, (C. C. A. 7th), decided November 27, 1939, not yet officially reported but found in 1939 C. C. H., Vol. 4, p. 10919, involving a similar situation, the court, although deciding in favor of the taxpayer, nevertheless plainly stated:

> * * * we do not believe as does the court in the *Bruun* case that *M. E. Blatt Co.* v. *United States, supra,* is controlling.

It is our position that upon termination of the lease, the lessor realized taxable income since he actually received something new and was enriched to that extent. Section 22 (a) of the Revenue Act of 1932 is broad and all inclusive in its terms. We contend that it embraces the present situation.

---

[5] Mr. Justice Stone concurred specially upon the ground that the findings failed to establish that the improvements involved produced any increase in the value of the taxpayer's property.

Our position is, therefore, substantially the same as that which we unsuccessfully sought to establish in *Miller* v. *Gearin*.[6]

II

THE LESSOR REALIZED TAXABLE INCOME UPON TERMINATION OF THE LEASE

1. Section 22 (a), in defining gross income, is all inclusive. In its broad sweep, Congress intended to make that definition co-extensive with its power under the Constitution. *Helvering* v. *Stockholms &c. Bank*, 293 U. S. 84, 89; *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 89; *Helvering* v. *Midland Ins. Co.*, 300 U. S. 216, 223; *Irwin* v. *Gavit*, 268 U. S. 161, 166. The scheme of the revenue acts is to tax *all* income,

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[6] The authority of *Miller* v. *Gearin* appears to have been somewhat impaired by this Court's decision in the *Blatt* case. In *Miller* v. *Gearin* the court supported its decision partly on the ground that if income is realized at any time from the construction of improvements it is realized immediately upon construction. This Court, in the *Blatt* case, rejected the view that the mere installation of improvements on land subject to a continuing lease may give rise to taxable income.

There is, however, one difference between this case and *Miller* v. *Gearin* that the court in the latter case might have regarded as crucial; namely, that title to the building, in *Miller* v. *Gearin* passed to the lessor immediately upon its construction, whereas in the instant case title did not pass until termination of the lease (R. 45). But the *Blatt* case expressly made immaterial the date when title passed. 305 U. S. at 280.

except to the extent that the statute specifically excludes any particular type of income. The gain to the lessor in the present case does not fall within any of those exclusions, nor does respondent contend that it does. The only ground upon which the tax is assailed is that the gain is not comprehended within Section 22 (a) itself. This is really a question of constitutional law, for, as pointed out above, the broad sweep of Section 22 (a) was intended to embrace every kind of gain or profit within the power of Congress. Any other view would produce hopeless confusion in the administration of the revenue laws; for there would result a no man's land between the external boundaries of the statutory and constitutional definitions of income—an area that would defy any intelligent effort at delimitation. The statutory definition of income is so broad and sweeping that it would require the most specious reasoning to place any gain or profit beyond its scope and yet within the definition of income as used in the Constitution.

If this problem is to be approached realistically, therefore, it must be recognized that the true question before the Court is whether the admitted gain which accrued to the lessor can be taxed to him under the Constitution. This was the problem as it was understood by Judge Learned Hand in *Hewitt Realty Co.* v. *Commissioner*, 76 F. (2d) 880,

884 (C. C. A. 2d), and it was in reliance upon the supposed constitutional requirement of "realization" set forth in *Eisner* v. *Macomber*, 252 U. S. 189, that the tax in the *Hewitt Realty Co.* case was declared invalid.

2. It seems clear that there is no constitutional objection to a tax upon the gain which accrues to the lessor upon the termination of the lease when he comes into possession of a newly constructed building. *Eisner* v. *Macomber* held that a dividend of common stock upon common stock could not be taxed as income, because the majority of the Court felt that the stockholder received nothing, that there had been no "realization." But, regardless of the soundness of *Eisner* v. *Macomber*, it is quite clear that where the stockholder receives stock of a different class, or stock which changes his relative position in the corporation, he has "realized" income.[7] And it is settled beyond question that income may be received in the form of property without the necessity of any subsequent sale. *Peabody* v. *Eisner*, 247 U. S. 347. The *Macomber* decision expressly left this result undisturbed (252 U. S. at 215), and it has been applied in a wide

[7] *Koshland* v. *Helvering*, 298 U. S. 441; *Helvering* v. *Gowran*, 302 U. S. 238. Cf. *Helvering* v. *Pfeiffer*, 302 U. S. 247. In these cases, however, the stock dividends involved were not taxed when received because of an express statutory exemption.

variety of situations.[8] The Revenue Acts[9] as well as the Treasury Regulations have long recognized that income may be received in the form of property.[10] Indeed, even the *purchase* of property at

[8] E. g., *United States* v. *Phellis*, 257 U. S. 156 (securities received pursuant to reorganization); *Marr* v. *United States*, 268 U. S. 536 (same); *Rockefeller* v. *United States*, 257 U. S. 176 (same); *Cullinan* v. *Walker*, 262 U. S. 434 (same); *James* v. *Commissioner*, 13 B. T. A. 764, affirmed on other issues, 49 F. (2d) 707 (C. C. A. 2d) (dividend paid in Liberty Bonds); *T. C. Power & Brother* v. *Commissioner*, 6 B. T. A. 835, appeal dismissed on procedural point, 27 F. (2d) 116 (C. C. A. 9th) (accounts receivable distributed as dividend); *Castle* v. *Commissioner*, 9 B. T. A. 931 (corporation gave lands to stockholder in return for bonds of lesser value); *Owen* v. *Commissioner*, 3 B. T. A. 905 (stock in other corporation distributed as dividend).

[9] Section 22 (a) of the Revenue Act of 1932, c. 209, 47 Stat. 169, defines "gross income" as including, *inter alia*, gains, profits, and income from salaries, wages or compensation for personal service, "of whatever kind and *in whatever form paid*." (Italics supplied.) "Dividends," also included in Section 22 (a), is defined in Section 115 (a) as "any distribution made by a corporation to its shareholders, whether in money or in other property." Similar provisions appear in Sections 22 (a) and 115 (a) of the Revenue Acts of 1928, c. 852, 45 Stat. 791, and Sections 213 (a) and 201 (a) of the Revenue Acts of 1926, c. 27, 44 Stat. 9; 1924, c. 234, 43 Stat. 253; 1921, c. 136, 42 Stat. 227; and 1918, c. 18, 40 Stat. 1057.

[10] Article 51 of Regulations 77, pertaining to the Revenue Act of 1932, provides: "Income may be in the form of cash or of property." Article 53 provides: "Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income." The identical provisions appear in Articles 51 and 53 of Regulations 74, pertaining to the Revenue Act of 1928, Articles 31 and 33 of Regulations 69, pertaining

a price substantially less than its fair market value may, under certain circumstances, be treated as an income producing transaction. See Regulations 77, Article 51;[11] *Salvage* v. *Commissioner*, 76 F. (2d) 112, 114 (C. C. A. 2d), affirmed, 297 U. S. 106; cf. *Elverson Corporation* v. *Commissioner*, 40 B. T. A. 614. In this situation, as in the case of the exchange of property, the absence of a sale and the fact that capital and gain are embodied in a single asset do not preclude realization.

Moreover, taxable income may be realized when neither money nor property is received. The requirement of realization has been deemed complied with by this Court upon the receipt of such benefits as the payment of taxpayer's indebtedness,[12] or

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to the Revenue Act of 1926, Articles 31 and 33 of Regulations 65, pertaining to the Revenue Act of 1924, and Articles 31 and 33 of Regulations 45, pertaining to the Revenue Act of 1918. Article 31 of Regulations 62, pertaining to the Revenue Act of 1921, is also identical with Article 51 of Regulations 77.

[11] Article 51 of Regulations 77 contains the following provision: "Where property is sold by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value." See also A. R. R. 6940, III-1 Cum. Bull. 32 (1924); I. T. 3204, 1938-2 Cum. Bull. 126; Regulations 77, Article 193.

[12] *United States* v. *Hendler*, 303 U. S. 564; *Duffin* v. *Lucas*, 55 F. (2d) 786 (C. C. A. 6th), certiorari denied, 287 U. S. 611.

taxes,[13] the satisfaction of other obligations,[14] or even the discharge of a mere "social duty."[15] Similarly, the release of funds from devotion to a specific liability to the general uses of the taxpayer, thus increasing "free" assets, may give rise to taxable income.[16]

Realization of income also occurs when taxpayer purchases its own obligations at less than the amount received for them. *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. The doctrine of the *Kirby Lumber* case has been extended to a situation in which the taxpayer's obligations were originally issued for property rather than money. *Helvering* v. *American Chicle Co.*, 291 U. S. 426. In that case, when the obligations were later discharged for less than par, the difference was held to constitute realized income, not a mere reduction in the purchase price of the property with no realization of gain until disposition of the property acquired, as the lower court there had held.[17]

In *Eisner* v. *Macomber*, the stock dividend was held nontaxable because the Court thought that the stockholder had not *received* anything. Although the result reached in the *Macomber* case is at best

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[13] *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716.

[14] *Douglas* v. *Willcuts*, 296 U. S. 1; *Helvering* v. *Schweitzer*, 296 U. S. 551; *Helvering* v. *Blumenthal*, 296 U. S. 552.

[15] *Burnet* v. *Wells*, 289 U. S. 670.

[16] See *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 352–353.

[17] *Commissioner* v. *American Chicle Co.*, 65 F. (2d) 454 (C. C. A. 2d).

doubtful, as may be seen from the vigorous dissents of Justices Holmes, Day, Brandeis, and Clarke, the present case is nevertheless sharply distinguishable.

The gain to the lessor was attributable to no mere enhancement in value of an existing asset. He actually received something new. He came into possession of his property and found a new and valuable building thereon. There can be no question as to its worth, for it is stipulated that it had a fair market value of $64,245.68. To say that the lessor has not received anything is to fly in the face of plain fact. He has been enriched, and has come into unfettered possession of a building which he did not own at the beginning of the lease. In the *Blatt* case, this Court held that no income accrued to the lessor so long as the lessee remained in possession. But here the lease has been forfeited and the lessor has come into full possession and enjoyment of the building, released from the rights previously enjoyed by the lessee.

Plainly, if the lessor succeeded to personal property which the lessee had been compelled to leave behind, he would have realized taxable income. Yet merely because the property here is affixed to the realty, and is therefore in the nature of real property itself, it is said that no income has been "realized" until the property is sold.[18] It is in-

[18] If the Government is compelled to await sale or final disposition of the property, then the gain involved will never be taxed in full, if at all. For the property will undoubtedly depreciate in value pending sale or disposition and such

conceivable that any such tenuous distinction was ever intended by the use of the word "income" in the Sixteenth Amendment.

Although the *Macomber* case pointed out (252 U. S. at 207) that income is gain "derived" from capital, and that it is something received by the taxpayer "for his *separate* use, benefit and disposal", it is immaterial that the income here (the building) was attached to and inseparable from the capital (the land). For it is firmly established that taxable income may be realized where property or securities are exchanged for other property or securities. *Cullinan* v. *Walker,* 262 U. S. 134; *Marr* v. *United States,* 268 U. S. 536. Yet in that situation there is inextricably combined in the property received both taxpayer's capital and the gain admittedly derived therefrom. In the present case, while the building received may not, as a practical matter, be readily capable of sale apart from the land, and while for purposes of real property law the land and the building are merged in one title, it is manifest that they are visibly separate and distinct physical assets. They were acquired at different times, from different sources, and by dissimilar

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decrease will probably be reflected in the sale price, thus diminishing or even entirely eliminating the amount of taxable income attributable to the lessee's improvements. Meanwhile, however, pending such sale or disposition, the lessor will have the full enjoyment of such property, just as if he had received the full amount in cash and invested it in such improvements himself.

transactions. Moreover, the obvious physical distinction between them is reflected in separate valuation for purposes of local taxes and in different treatment for purposes of depreciation and obsolescence in federal income tax law. Indeed, as was pointed out in *Commissioner* v. *Center Investment Co.* (C. C. A. 9th), decided November 27, 1939, not yet reported officially but found in 1939 C. C. H., Vol. 4, p. 10,927, 10,928, title to land and to the building upon it may be vested in different persons. *Fairbanks* v. *S. F. & N. P. Ry. Co.*, 115 Cal. 579, 583–584; cf. *Lillibridge* v. *Lackawanna Coal Co.*, 143 Pa. 293.

3. In deciding against the Government, the court below relied upon the *Blatt* case as controlling (R. 46). But, as we have already endeavored to show, *supra*, pp. 9–10, the *Blatt* case merely held that no income was realized by the lessor *prior* to termination of the lease, since the lessor "had no right to use or dispose of them [improvements] during the term", and there was accordingly no "contemporaneous realization of gain." 305 U. S. at 280. Moreover, as this Court was careful to point out, the findings in the *Blatt* case failed to show that the so-called improvements made by the lessee increased the value of the property (305 U. S. at 278–279), and it was upon this basis that Mr. Justice Stone concurred. The question whether a new building constructed by the lessee which became the property of the lessor subject to his unrestricted use at the termination of the lease constitutes tax-

able income to the lessor at such termination was not decided in the *Blatt* case. 305 U. S. at 276–277. That is the question for decision here.

It is true that there is some language in the *Blatt* opinion which, when considered apart from the facts there before the Court, would appear to give color to respondent's position here. The Court said (p. 279):

> Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor. So far as concerns taxable income, the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. * * *

The Court plainly could not have intended that language to be taken at its face unrelated to the facts *sub judice*. There is no mere enhancement in value in this case. The lessor has actually received something of considerable value. And that clear gain is income in its truest sense, income that was realized upon cancellation of the lease.

However, if that language is to read literally, then we respectfully ask that it be reconsidered. Of course, a lessor does not realize income when he expends money to make improvements on his own property; he merely makes a capital investment and derives no gain therefrom. But here the improvements were made by the lessee and actually enriched the lessor. The gain was realized upon forfeiture of the lease, when the

lessor for the first time obtained the unrestricted use of the new building. The situation should not be confused by labeling that gain as an addition to "capital." In a sense, whenever an asset is sold or exchanged for consideration in excess of its cost or other basis there is a "capital gain." Yet it is clear beyond question that a realized capital gain constitutes taxable income. And it is equally clear that a sale is not essential to realization, since income may be realized in a variety of ways including the receipt of property.

Hewitt Realty Co. v. *Commissioner*, 76 F. (2d) 880 (C. C. A. 2d), relied upon by the court below, merely held, as did the *Blatt* case, that improvements made by the lessee do not constitute taxable income in a year prior to termination of the lease.[19] Although the case is thus distinguishable upon its

[19] The case is further distinguishable in that, by the terms of the lease, lessee had a contingent option to renew for three successive periods of 21 years. The Commissioner added to taxpayer's income the aliquot part of the depreciated value of the building for the year in question on the assumption that the controlling term of the lease was 21 years. As was pointed out in the separate opinion of Judge Chase, page 883, the option of renewal "put it in the power of the lessee to deprive the lessor of possession and control of the building during all the time it had value." Even renewal for one term would have put the date of termination beyond the agreed depreciated life of the building. For that reason, Judge Chase believed the Commissioner's determination was erroneous. The prevailing opinion likewise adverted to the possibility of the lessee's renewal, which it regarded as an additional support for its conclusion that no taxable income had been realized (p. 885).

facts, the criterion of realization adopted by the majority is nevertheless contrary in the main to our present position. Under their view (p. 884), no income is realized unless the "value received is embodied in something separately disposable." Therefore, according to their view the gain represented by the building could not be taxed until the property is sold, and the result was placed squarely upon constitutional grounds. But we have already discussed the fallacy of the theory that there is a constitutional impediment which forbids the tax, and respectfully submit that Judge Chase's separate opinion in the *Hewitt Realty* case represents the correct view in this respect. The theory expounded by Judge Learned Hand for the majority, which we believe to be unsound, has since been adopted in a number of cases in the Board as well as in other federal courts.[20] In view of its drastic character, relying upon specious constitutional grounds to invalidate a tax upon clear gain,

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[20] *Nicholas* v. *Fifteenth Street Inv. Co.*, 105 F. (2d) 289 (C. C. A. 10th); *Commissioner* v. *Wood* (C. C. A. 7th), decided November 27, 1939, not yet officially reported but found in 1939 C. C. H., Vol. 4, p. 10,919; *Commissioner* v. *Center Investment Co.* (C. C. A. 9th), decided November 27, 1939, not yet officially reported but found in 1939 C. C. H., Vol. 4, p. 10,927; *English* v. *Bitgood*, 21 F. Supp. 641 (Conn.); *Marshall* v. *Glenn* (W. D. Ky.), decided February 17, 1939, not officially reported but found in 1939 C. C. H., Vol. 4, p. 9694; *Dominick* v. *United States*, 24 F. Supp. 829 (S. D. N. Y.); *Staples* v. *United States*, 21 F. Supp. 737 (E. D. Pa.); *Hilgenberg* v. *United States*, 21 F. Supp. 453 (Md.); *Cleveland Trust Co.* v. *Commissioner*, 39 B. T. A. 113;

and in view of its widespread acceptance among the lower tribunals, including the court below, we respectfully ask that it be specifically disapproved.

4. We have contended that the gain to the lessor is embraced within the all-inclusive definition of gross income which is coextensive with the meaning of "income" as used in the Sixteenth Amendment, and we have undertaken to show that the gain here in question is within the terms of the Sixteenth Amendment. However, in order to dispel any possible confusion, we believe that it will be helpful to consider briefly the precise nature of the Sixteenth Amendment, and its relationship to the taxing power.

The basic power of Congress to levy taxes is derived from Article I, Section 8, Clause 1 of the Constitution, which provides:

> The Congress shall have power to lay and collect taxes, duties, imposts, and excises, to

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Merkra Holding Co. v. *Commissioner*, 39 B. T. A. 117; *Stimson Corp.* v. *Commissioner*, 38 B. T. A. 303; *Durkheimer Investment Co.* v. *Commissioner*, 36 B. T. A. 423; *Brookside Realty Co.* v. *Commissioner*, Memorandum Opinion, B. T. A., March 20, 1939 (pending C. C. A. 2d); *The Hills Corp.*, Memorandum Opinion, B. T. A., March 27, 1939 (pending C. C. A. 10th); *Heppenheimer* v. *Commissioner*, Memorandum Opinion, B. T. A., April 6, 1939 (pending C. C. A. 2d); *Millikin* v. *Commissioner*, Memorandum Opinion, B. T. A., June 29, 1939 (pending C. C. A. 6th); *Estate of Stuyvesant* v. *Commissioner*, Memorandum Opinion, B. T. A., July 8, 1939, *Estate of Brant*, Memorandum Opinion B. T. A., April 17, 1939 (pending C. C. A. 6th); cf. *Slack* v. *Commissioner*, 35 B. T. A. 271, petition dismissed, 91 F. (2d) 1011 (C. C. A. 9th).

> pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States;

The authority so conferred "is exhaustive and embraces every conceivable power of taxation." *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 12. The Constitution itself imposes but three restrictions upon the exercise of that power: (1) duties, imposts, and excises must be uniform throughout the United States (Art. I, Sec. 8, cl. 1); (2) direct taxes must be apportioned among the states according to population (Art. I, Sec. 2, cl. 3, and Art. I, Sec. 9, cl. 4); and (3) no tax or duty may be laid upon exports (Art. I, Sec. 9, cl. 5).

Apart from the foregoing restrictions the power to tax is plenary. And it would seem that there could not be any constitutional objection to the imposition of a tax upon income or gains of any kind. Income taxes were levied during the Civil War period, and were regarded as valid. However, in *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, 158 U. S. 601, it was held that a tax upon income derived from property is a direct tax, and therefore is invalid unless apportioned among the states according to population. It is important to note that the Court did not declare Congress to be without any power to impose income taxes; it merely held that certain income taxes are direct, and must be apportioned if they are levied.

The Sixteenth Amendment was adopted in response to the *Pollock* decision. It is not intended as a *limitation* upon the taxing power. It was intended to *expand* the taxing power and to remove the impediment which the majority of the Court thought existed in the *Pollock* case.

Accordingly, it is incorrect to say a tax is "forbidden" by the Sixteenth Amendment. That amendment contains no prohibition or limitation whatever. The plenary power to tax is still conferred by Article I, Section 8, Clause 1, and the Sixteenth Amendment simply implements that power and removes the requirement of apportionment.

If the tax here involved is invalid, its invalidity arises not because Congress has no power to impose a tax upon such gain, but rather because it is a direct tax and must be apportioned among the states in accordance with population—i. e., that the Sixteenth Amendment has merely failed to overcome the objection found in the *Pollock* case. However, it seems clear that a tax upon such gain is valid wholly apart from the Sixteenth Amendment since it is not a direct tax. And in any event the tax is valid since the Sixteenth Amendment was intended "to get rid of nice questions as to what might be direct taxes" (Holmes, J., dissenting in *Eisner* v. *Macomber*, 252 U. S. 189, 220).

CONCLUSION

In every real sense the lessor was enriched and received something new upon the termination of the lease. The gain arising from that transaction was income to him within the meaning of Section 22 (a) and there is no constitutional provision which prohibits the imposition of the tax. The decision below, invalidating the tax, is erroneous and should be reversed.

Respectfully submitted.

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JANUARY 1940.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from * * * sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Treasury Regulations 77, promulgated under the Revenue Act of 1932:

Art. 63 [as amended by T. D. 4539, XIV–1 Cum. Bull. 141 (1935)].—*Improvements by lessees.*—If buildings are erected or improvements made by a lessee and such buildings or improvements immediately become the property of the lessor, as, for instance, if they are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(a) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease.

(b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the expiration of the lease and report as income

for each year of the lease an aliquot part thereof.

If the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor shall report income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he becomes entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the termination of the lease shall be included.

* * * * * *

Prior to the amendment by T. D. 4539, Article 63 read in full as follows:

ART. 63. *Improvements by lessees.*—When buildings are erected or improvements made by a lessee in pursuance of an agreement with the lessor, and such buildings or improvements are not subject to removal by the lessee, the lessor may at his option report the income therefrom upon either of the following bases:

(a) The lessor may report as income at the time when such buildings or improvements are completed the fair market value of such buildings or improvements subject to the lease.

(b) The lessor may spread over the life of the lease the estimated depreciated value of such buildings or improvements at the expiration of the lease and report as income for each year of the lease an aliquot part thereof.

Except in cases where the lessor has exercised the option to report income upon

basis (b), if the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor derives no income by reason thereof, and, just as when the lessor comes into possession or control of the property upon the expiration of the lease, the basis for determining gain or loss to the lessor from the subsequent sale or other disposition of the buildings or improvements and for depreciation in respect of such property is the amount previously reported as income by the lessor because of the erection of the buildings or improvements, except that if the buildings or improvements were acquired prior to March 1, 1913, the basis shall be their value subject to the lease when acquired or their value subject to the lease on March 1, 1913, whichever is greater. If the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise. If the buildings or improvements destroyed were acquired prior to March 1, 1913, the deduction shall be based on their value subject to the lease when acquired or their value subject to the lease on March 1, 1913, whichever is greater, less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise. (See articles 130 and 204.)

In all cases where the lessor has exercised the option to report income upon basis (b),

if the lease is terminated so that the lessor comes into possession or control of the property prior to the time originally fixed for the expiration of the lease, the lessor derives additional income for the year in which the lease is so terminated to the extent that the value of such buildings or improvements when he becomes entitled to such possession exceeds the amount already reported as income on account of the erection of such buildings or improvements. No appreciation in value due to causes other than the termination of the lease shall be included. If the buildings or improvements are destroyed prior to the expiration of the lease, the lessor is entitled to deduct as a loss for the year when such destruction takes place the amount previously reported as income because of the erection of such buildings or improvements, less any salvage value subject to the lease to the extent that such loss is not compensated for by insurance or otherwise.

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Supreme Court of the United States

OCTOBER TERM, 1939

No. 479

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

VS.

CHARLES A. BRUUN, RESPONDENT

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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Opinion Below

The memorandum opinion of the Board of Tax Appeals (R. 30) is unreported. The opinion of the Circuit Court of Appeals (R. 43-46) is reported at 105 F. (2d) 442.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on July 24, 1939 (R. 47). The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented

Where a lessee constructs a building on leased premises under a contract which provides that the building shall be the property of the lessee during the life of the lease, but shall become the property of the lessor upon termination of the lease, and the lease is thereafter cancelled, does the lessor derive income in the year of the cancellation of the lease to the extent of the then value of the building?

Statutes and Regulations Involved

The statutes and regulations are set out in the petition filed herein, pages 2 to 4.

Statement

The facts, as stipulated (R. 13-30) and found by the Board of Tax Appeals (R. 30), are as follows:

On July 1, 1915, Charles A. Bruun, being then the owner of a parcel of improved real estate located at the southeast corner of Twelfth Street and Grand Avenue, Kansas City, Missouri, leased the same to Newmarket Investment Company for a period of 99 years (R. 14) running from July 1, 1915, and ending June 30, 2014 (R. 16). The lease provided for the payment of rent as follows:

> $5,000.00 upon the execution of the lease
> 1,000.00 a month to July 1, 1918
> 1,666.66 a month to July 1, 1922
> 2,083.33 a month to July 1, 1925
> 2,500.00 a month to July 1, 2014 (R. 17).

The lease required the payment of all taxes by the lessee (R. 18), and authorized the lessee to remove or tear down any buildings then, or which might thereafter be placed, upon the premises, provided it should first deliver to the lessor a bond guaranteeing the payment

of all rent and the performance of all the conditions of the lease for a period of two years after the beginning of the removal or demolition of such building or buildings (R. 20-21). The lessee was authorized, but not required, to place new buildings upon the premises (R. 20). The lease provided for forfeiture for failure to pay rent or taxes, and provided that no buildings should be removed from the premises or torn down after forfeiture (R. 21-22, 28), or after the year 2010 (R. 21). It provided that upon termination of the lease the lessee would "yield up to the first party the lands hereby leased with all buildings, improvements, fixtures and appliances situated thereon" (R. 28). The lessee went into possession and during the latter part of 1929 tore down the old building which then had a depreciated cost to the Respondent of $13,365.00, and prior to December 31, 1929, it constructed a new building upon the premises which had a useful life of less than 50 years.

On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was cancelled and the Respondent went into possession of the property. The building thereon, which had been constructed by the lessee, had a value at that date of $64,245.68. The undepreciated cost of the old building torn down in 1929, amortized to July 1, 1933, was $12,811.43, which sum, when deducted from the $64,245.68, left a balance of $51,434.25 (R. 14). Neither this sum nor any part thereof was reported by the Respondent in his income tax return filed with the Collector of Internal Revenue at Kansas City, Missouri, for the year 1933. Upon auditing Respondent's return, the Commissioner added $51,434.25 to Respondent's gross income and determined a deficiency of $4,111.43 (R. 15).

The Board of Tax Appeals held that no gain was realized in 1933 (R. 30), and the Circuit Court of Appeals affirmed (R. 46). Petitioner seeks to bring the question thus presented to this Court for review.

ARGUMENT

I

The Question Here Presented Has Received a Clear and Authoritative Answer

Petitioner contends (Pet. 5-8) that the question here presented has never received an authoritative answer, and he therefore requests (Pet. 10) that the petition be granted. We submit that Petitioner's premise is erroneous. Here, the lessee reserved the right to remove the building from the leased premises (R. 20-21). It was only upon "the expiration of the term of this lease either by lapse of time or by forfeiture" (R. 28) that the building was to become that of the lessor. It follows that simultaneously with the termination of the lease the building became a part of the realty (*Shelton* v. *Jones*, 66 Okla. 83, 167 Pac. 458; *Hughes* v. *Kershow*, 42 Colo. 210, 93 Pac. 1116), with the result that Respondent never acquired possession or control of anything other than improved realty. The result was precisely the same as though the building had at that time been placed upon the land by the lessee under a contract whereby it became the property of the lessor when constructed. Thus, the facts are in all material respects the same as those presented to this Court in *M. E. Blatt Co.* v. *United States*, 305 U. S. 267. In that case improvements were placed upon the land by the lessee under a contract whereby they immediately attached to the realty and became the property of the lessor. In holding that no gain resulted to the lessor at the time the improvements became his, this Court said (p. 279):

> Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor. So far as concerns taxable income, the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was

an addition to capital; not income within the meaning of the statute.

Thus, this Court in unequivocal language has stated that even though improvements placed upon land enhances the value of the land, such value is not distinguishable from excess of value over cost of improvements made by the owner. Each is an addition to capital, and neither constitutes taxable income within the meaning of the statute. Language more decisive of the issue here presented could not well be employed. That this holding represented a part of the Court's decision and was not dictum is conclusively shown by the fact that Mr. Justice Stone unsuccessfully attempted to limit the Court's decision to another ground. It follows that the question which Petitioner seeks to present has received an authoritative and unequivocal answer.

This was the view taken by the Circuit Court of Appeals herein. It said (R. 46):

> While in the cited case [*M. E. Blatt Co.* v. *United States*, and others] the title to the improvements placed upon the leased premises by the lessee vested in the lessor under the terms of the lease at the time the improvements were made, whereas in the instant case title did not vest until the lease was terminated in a subsequent year, the principle is the same in all of them. The rule stated by the Supreme Court in the *Blatt Case*, *supra*, is controlling. No income was realized by the respondent in 1933 by reason of the cancellation of the lease.

In an effort to distinguish the holding in the *Blatt Company* case from the decision of the Circuit Court of Appeals herein, Petitioner says (Pet. 8):

> The decision below is a misapplication of *M. E. Blatt Co. v. United States*, 305 U. S. 267. There the lease was still in effect, and while the owner's property had been improved without expense to it, the lessee was presently in possession. This court held

(p. 280) that the owner "had no right to use or dispose of them [the improvements] during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute."

An examination of the *Blatt Company* decision will disclose that Petitioner does not correctly represent what this Court actually said. As we have pointed out above, it first held that the improvements were mere additions to capital, not income within the meaning of the statute. It then went on to say (p. 280):

> *But, assuming* that at some time value of the improvements would be income of lessor, it cannot be reasonably assigned to the year in which they were installed. The commissioner found that at the end of the term some would be worthless and excluded them. He also excluded depreciation of other items. These exclusions imply that elements which will not outlast lessee's right to use are not at any time income of lessor. The inclusion of the remaining value is to hold that petitioner's right to have them as a part of the building at expiration of lease constitutes income in the first year of the term in an amount equal to their estimated value at the end of the term without any deduction to obtain present worth as of date of installation. It may be assumed that, subject to the lease, lessor became owner of the improvements at the time they were made. *But it had no right to use or dispose of them during the term. Mere acquisition of that sort did not amount to contemporaneous realization of gain within the meaning of the statute.* [Italics supplied.]

Thus, it will be seen that this Court first held that the improvements were additions to capital and not income within the meaning of the statute. It then went on to say that *even if it had taken a different view of the primary question,* nevertheless its decision would have been against the Government, for the reason which Petitioner now argues was the ground of the decision. However, inasmuch as the statement quoted by Petitioner

was based upon an assumption which had previously been found to be false, it is obvious that it was intended as, and was nothing more than, secondary or additional argument. It did not change the fact that the Court's primary reason for denying that income resulted to the lessor at the time the building was attached to the land was that "the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute." Accordingly, we submit that by lifting a sentence from its setting Petitioner has placed an erroneous construction upon what this Court actually held in the *Blatt Company* case.

II

There Is No Conflict in the Decisions with Respect to the Question Here Presented

Aside from the decision of this Court in the *M. E. Blatt Company* case, it has been held that where, as here, a lessee places improvements upon the land of the lessor during the term of the lease, no income results to the owner, either at the time the improvements are placed upon the premises (*Hewitt Realty Co.* v. *Commissioner*, (C. C. A. 2) 76 F. (2d) 880[1]), or upon the termination of the lease (*Miller* v. *Gearin*, (C C. A. 9) 258 Fed. 225, certiorari denied 250 U. S. 667; *Fifteenth Street Inv. Co.* v. *Nicholas*, (C. C. A. 10) 105 F. (2d) 289; *Cryan* v. *Wardell*, (N. D. Cal.) 263 Fed. 248; *Dominick* v. *United States*, (S. D. N. Y.) 24 F. Supp. 829; *Slack* v. *Commissioner*, 35 B. T. A. 271, appeal dismissed, *Commissioner* v. *Slack*, (C. C. A. 9) 91 F. (2d) 1011; *F. S. Stimson Corp.* v. *Commissioner*, 38 B. T. A. 303; and *Cleveland Trust Co.* v. *Commissioner*, 39 B. T. A. 113). There is no con-

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[1]Cited with approval by this Court in **M. E. Blatt Company v. United States, supra**, p. 279, Note 7.

trary decision upon the latter point, and this Court, in the *Blatt Company* case, definitely affirmed the *Hewitt Realty Company* case.

Conclusion

The question here presented was clearly and unequivocally decided by this Court in its decision in *M. E. Blatt Co.* v. *United States*, *supra*. It was correctly decided by the Court below. In any event it has been squarely decided, contrary to the Petitioner's position, by other courts and the Board of Tax Appeals, and there is no conflict in any of the decisions. Accordingly, we respectfully submit that the petition for writ of certiorari should be denied.

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Supreme Court of the United States

OCTOBER TERM, 1939

No. 479

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

VS.

CHARLES A. BRUUN, RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR THE RESPONDENT

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Supreme Court of the United States

OCTOBER TERM, 1939

No. 479

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VS.

CHARLES A. BRUUN, RESPONDENT.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 30) is unreported. The opinion of the Circuit Court of Appeals (R. 43-46) is reported at 105 F.(2d) 442.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 24, 1939 (R. 47), and petition for writ of cer-

tiorari was filed October 21, 1939, and was granted November 22, 1939. The jurisdiction of this Court is conferred by Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The question presented is whether a lessor derives income in the year of the cancellation of a lease to the extent of the then value of a building erected by the lessee and forfeited to the lessor upon the termination of the lease because of its breach.

CONSTITUTIONAL AMENDMENT AND STATUTE INVOLVED[1]

Sixteenth Amendment to the Constitution:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Revenue Act of 1932, Chap. 209, 47 Stat. 169:

SEC. 22. GROSS INCOME

> (a) "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

---

[1]Article 63 of Treasury Regulations 77, promulgated under the Revenue Act of 1932, as amended by T. D. 4539, XIV-1, C. B. 141, was held to be void by this Court in **M. E. Blatt Co. v. United States**, 305 U. S. 267.

STATEMENT OF FACTS

The facts as stipulated (R. 13-15) and found by the Board of Tax Appeals (R. 30) are as follows:

On July 1, 1915, Charles A. Bruun, being then the owner of a parcel of improved real estate located at the southeast corner of Twelfth Street and Grand Avenue, Kansas City, Missouri, leased the same to Newmarket Investment Company for a period of 99 years (R. 14), running from July 1, 1915, and ending June 30, 2014 (R. 16). The lease provided for the payment of rent as follows:

$ 5,000.00 upon the execution of the lease
1,000.00 a month to July 1, 1918
1,666.66 a month to July 1, 1922
2,083.33 a month to July 1, 1925
2,500.00 a month to July 1, 2014 (R. 17)

The lease required the payment of all taxes by the lessee (R. 18), and authorized the lessee to remove or tear down any buildings then, or which might thereafter be placed, upon the premises, provided it should first deliver to the lessor a bond guaranteeing the payment of all rent and the performance of all the conditions of the lease for a period of two years after the beginning of the removal or demolition of such building or buildings (R. 20-21). The lessee was *authorized*, but *not required*, to place new buildings upon the premises (R. 20, 25). The lease provided for forfeiture for failure to pay rent or taxes, and provided that no buildings should be removed from the premises or torn down after forfeiture (R. 21-22, 28), or after the year 2010 (R. 21). It provided that upon termination of the lease the lessee would "yield up to the first party the lands hereby leased with all buildings, improvements, fixtures and appliances situate thereon" (R. 28). The lessee went into possession and during the

latter part of 1929 tore down the old building which then had a depreciated cost to the Respondent of $13,365, and prior to December 31, 1929, it constructed a new building upon the premises which had a useful life of less than 50 years.

On July 1, 1933, the lessee being in default in the payment of rent and taxes, the lease was cancelled and the Respondent went into possession of the property. The building thereon, which had been constructed by the lessee, had a value at that date of $64,245.68. The undepreciated cost of the old building torn down in 1929, amortized to July 1, 1933, was $12,811.43, which sum, when deducted from the $64,245.68, left a balance of $51,434.25 (R. 14). Neither this sum nor any part thereof was reported by the Respondent in his income tax return filed with the Collector of Internal Revenue at Kansas City, Missouri, for the year 1933. Upon auditing Respondent's return, the Commissioner added $51,434.25 to Respondent's gross income and determined a deficiency of $4,111.43 (R. 15).

The Board of Tax Appeals held that no gain was realized from the cancellation of the lease in 1933 (R. 30) and the Circuit Court of Appeals affirmed (R. 46).

SUMMARY OF ARGUMENT

To derive from capital, income taxable under the several Revenue Acts enacted since the adoption of the Sixteenth Amendment, it is essential that there be a growth or increment of value in the property and that this be so severed from the capital and received by the owner as to make it available for his separate benefit and disposal. *Eisner* v. *Macomber*, 252 U. S. 189, 207; *United States* v. *Phellis*, 257 U. S. 156, 168-169; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 519-520; *Taft* v. *Bowers*, 278 U. S. 470, 482; *United States* v. *Safety Car Heating & L. Co.*, 297 U. S. 88, 99. Not only must such severed

increment in value be reduced to possession, but it must be in cash or in such form as to be readily reducible to cash. *Burnet* v. *Logan*, 283 U. S. 404, 413-414; *Commissioner* v. *Wood* (C.C.A. 7), 107 F.(2d) 869; *O'Meara* v. *Commissioner* (C.C.A. 10), 34 F.(2d) 390, 395; *Champlin* v. *Commissioner* (C.C.A. 10), 71 F.(2d) 23, 29; *Schoenheit* v. *Lucas* (C.C.A. 4), 44 F.(2d) 476, 479-480; *Mount* v. *Commissioner* (C. C. A. 2), 48 F.(2d) 550, 552; *Bourn* v. *McLaughlin* (D.C. Cal.), 19 F.(2d) 148, 150. Otherwise, the owner would be required to pay a tax out of capital and an income tax would be converted into a capital levy. This may not be done. *Koshland* v. *Helvering*, 298 U. S. 441, 445-446; *Goodrich* v. *Edwards*, 255 U. S. 527, 535.

Where a lessee constructs a building upon the premises of the lessor the building attaches to and becomes a part of the realty either at the time of its erection (*Holtgreve* v. *Sobolewski*, 326 Mo. 412, 422; see, *Havens* v. *Fire Insurance Co.*, 123 Mo. 403, 419; *Climer* v. *Wallace*, 28 Mo. 556-559), or, as in the instant case, simultaneously with the termination of the lease (*Shelton* v. *Jones*, 66 Okla. 83; *Hughes* v. *Kershow*, 42 Colo. 210). Accordingly, even though the building increases the value of the land, instead of that increase in value being severed from the capital and made available for the taxpayer's separate use and disposal, it attaches to and, for the first time, becomes a part of the capital. It is nothing more than an increment of value in the property. It is not unlike the result of a good bargain, and it is well settled that such a result does not constitute taxable income. *Palmer* v. *Commissioner*, 305 U. S. 63, 68-69; *Rose* v. *Trust Co.* (C.C.A. 5), 28 F.(2d) 767, 776, 778; *Commissioner* v. *VanVorst* (C.C.A. 9), 59 F.(2d) 677, 680; *Taplin* v. *Commissioner* (C.C.A. 6), 41 F.(2d) 454; *Rossheim* v. *Commissioner* (C.C.A. 3), 92 F. (2d) 247, 249; *Omaha National Bank* v. *Commissioner* (C.C.A. 8), 75 F.(2d) 434, 436; *Everhart* v. *Commissioner*, 26 B.T.A. 318; *Geeseman*

v. *Commissioner*, 38 B.T.A. 258, 264, acquiesced in by the Commissioner, C. B. 1939-1, page 13.

These principles have been accepted and applied adversely to the Government's contention by every court dealing with the question whether income accrues to a lessor by reason of the construction of a valuable building upon his property by the lessee (*M. E. Blatt Co.* v. *United States*, 305 U. S. 267; *Commissioner* v. *Center Investment Co.* (C.C.A. 9), 108 F.(2d) 190; *Commissioner* v. *Wood* (C.C.A. 7), 107 F.(2d) 869; *Helvering* v. *Bruun* (C.C.A. 8), 105 F.(2d) 442; *Nicholas* v. *Fifteenth Street Investment Co.* (C.C.A. 10), 105 F.(2d) 289; *Dominick* v. *United States* (D.C. S.D. N.Y.), 24 F.Supp. 829; *English* v. *Bitgood* (D.C. Conn.), 21 F.Supp. 641; *Staples et al* v. *United States* (D.C. E.D. Pa.), 21 F.Supp. 737; *Hilgenberg* v. *United States* (D.C. Md.), 21 F.Supp. 453; *Hewitt Realty Co.* v. *Commissioner* (C.C.A. 2), 76 F.(2d) 880; *Cryan* v. *Wardell* (N.D. Cal.), 263 Fed. 248; *Miller* v. *Gearin* (C.C.A. 9), 258 Fed. 225), with the exception of the Court of Claims in *M. E. Blatt Co.* v. *United States*, 23 F.Supp. 461, and the District Court for the Western District of Kentucky in *Kentucky Block Coal Co.* v. *Lucas*, 4 F.Supp. 266, both of which were overruled by this Court in *M. E. Blatt Co.* v. *United States, supra.*

The Board of Tax Appeals has also consistently held that no income results to a lessor upon cancellation of a lease even though he comes into possession of a valuable building constructed upon the premises by the lessee. *Scott* v. *Commissioner*, 9 B.T.A. 1219; *Alexander* v. *Commissioner*, 13 B.T.A. 1169; *Martin* v. *Commissioner*, 24 B.T.A. 813; *Slack* v. *Commissioner*, 35 B.T.A. 271, petition for review dismissed (C.C.A. 9), 91 F.(2d) 1011; *Durkheimer Investment Co.* v. *Commissioner*, 36 B.T.A. 423; *F. S. Stimson Corp.* v. *Commissioner*, 38 B.T.A. 303, 307; *Cleveland Trust Co.* v. *Commissioner*, 39 B.T.A. 113.

ARGUMENT

Respondent Realized No Taxable Income upon Termination of the Lease

The Sixteenth Amendment to the Constitution authorized Congress "to lay and collect taxes on income from whatever *source derived*." [Italics ours.]

Section 22(a) of the Revenue Act of 1932, so far as here material, defines the term "gross income" as including

> * * * gains, profits and income *derived from* * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * * or gains or profits and income *derived from* any source whatever. [Italics ours.]

In an unbroken line of decisions this Court has consistently held that before income can be said to be "derived from" capital, it is necessary not only that there be a growth or increment of value in the property, but there must be something of exchangeable value severed from the property and received by the taxpayer for his separate use, benefit, and disposal. *Eisner* v. *Macomber*, 252 U. S. 189, 207; *United States* v. *Phellis*, 257 U. S. 156, 168-169; *Merchants Loan & Trust Co.* v. *Smietanka*, 255 U. S. 509, 519-520; *Taft* v. *Bowers*, 278 U. S. 470-482; *Goodrich* v. *Edwards*, 255 U. S. 527, 535; *United States* v. *Safety Car Heating & L. Co.*, 297 U. S. 88, 99.

In *Eisner* v. *Macomber*, *supra*, this Court had before it the question whether a stock dividend constituted income which could be reached by an income tax statute, and with respect to the essential characteristics of a gain derived from property it said, pages 206-209:

> * * * For the present purpose we require only a clear definition of the term "income" as used in com-

mon speech, in order to determine its meaning in the Amendment; * * *

After examining dictionaries in common use * * * we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of August 5, 1909 * * *: "Income may be defined as the gain derived from capital, from labor, or from both combined," provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle case * * *.

Brief as it is, it indicates the characteristic and distinguishing attribute of income, essential for a correct solution of the present controversy. The Government although basing its argument upon the definition as quoted, placed chief emphasis upon the word "gain", which was intended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived,--"*derived--from--capital*";--"*the gain--derived--from--capital*" etc. Here we have the essential matter: *Not* a gain *accruing* to capital, not a *growth* or *increment* of value in the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in*, being "*derived*", that is, *received* or *drawn* by the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. Nothing else answers the description.

The same fundamental conception is clearly set forth in the Sixteenth Amendment. -- "Incomes, *from* whatever *source derived*",--the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution.

Thus, it will be seen that this Court has recognized the import of the phrase "derived from" as used both in the constitutional amendment and in the statute, and has held that before there can be a taxable income "derived from" property there must be a growth or increment of value in the investment and it must be so severed from the capital as to make it available for the taxpayer's

separate use and disposal. This definition of income was reiterated in *United States* v. *Phellis, supra,* wherein this Court had before it the question whether a certain corporate distribution constituted a taxable dividend within the meaning of a statute similar to Section 22(a), *supra.* With regard thereto the Court said, page 169:

> * * * Disregarding the slight looseness of construction, we interpret "gains, profits, and income derived *from* * * * dividends", etc., as meaning not that everything in the form of a dividend must be treated as income, but that income derived *in the way of* dividends shall be taxed. Hence the inquiry must be whether the shares of stock in the new company received by claimant as a dividend by reason of his ownership of stock in the old company constituted * * * a gain derived from capital, not a gain accruing to capital, nor a growth or increment of value in the investment, but a gain, a profit, something of exchangeable value proceeding from the property, severed from the capital, however invested, and coming in,--that is, received or drawn by the claimant for his separate use, benefit, and disposal.

Thus, again we have this Court recognizing that before one can derive income from property he must receive something which may be used and disposed of separate and apart from his capital. The definition of income laid down in these two decisions has been consistently followed, and, so far as we have been able to ascertain, never departed from by this Court.

Applying the rule laid down in these decisions, it has been held that before there can be any taxable gain a consideration must be received and it must be in cash or in such form as to be readily reducible to cash. *Burnet* v. *Logan,* 283 U. S. 404, 413-414; *Commissioner* v. *Wood* (C.C.A. 7), 107 F.(2d) 869; *O'Meara* v. *Commissioner* (C.C.A. 10), 34 F.(2d) 390, 395; *Champlin* v. *Commissioner* (C.C.A. 10), 71 F.(2d) 23, 29; *Schoenheit* v. *Lucas* (C.C.A. 4), 44 F.(2d) 476, 479-480; *Mount* v. *Commissioner* (C.C.A. 2), 48 F.(2d) 550, 552; *Bourn* v. *McLaugh-*

lin (D.C. Cal.), 19 F. (2d) 148, 150. The recipient must have acquired something apart from his capital out of which he can discharge the government exaction. *Commissioner* v. *Wood* (C.C.A. 7), 107 F.(2d) 869, 872. Otherwise, an income tax statute would be converted into a capital levy, and it is well settled that that may not be done. *Koshland* v. *Helvering*, 298 U. S. 441, 445-446; *Goodrich* v. *Edwards*, 255 U. S. 527; 535.

With these fundamental characteristics of income in mind it is pertinent that we turn to a consideration of the nature of the gain, if any, accruing to the lessor upon the forfeiture of a lease where a valuable building has been placed upon the premises by the lessee. It is well settled that in such a case the building attaches to and becomes a part of the realty either at the time of its erection (*Holtgreve* v. *Sobolewski*, 326 Mo. 412, 422; see, *Havens* v. *Fire Insurance Co.*, 123 Mo. 403, 419; *Climer* v. *Wallace*, 28 Mo. 556, 559) or, as in the instant case, simultaneously with the termination of the lease (*Shelton* v. *Jones*, 66 Okla. 83; *Hughes* v. *Kershow*, 42 Colo. 210). Accordingly, in instances where the building actually increases the value of the land, instead of such increment of value being so severed from the capital as to make it available for the taxpayer's separate use and disposal, the result is exactly the converse. The building, instead of being severed from the property, becomes a part of it, and where the improvement is in the form of a store and office building, as manifestly was the situation here,[2] it is a matter of common knowledge that it could not be removed from the premises except by its demolition. A building which is not movable from the premises on which it stands could not be sold or disposed of separate and apart from the land, as any conveyance

[2] This is apparent from the fact that at the time the lease was cancelled, it provided for a rental of $2,500 a month, or $30,000 a year (R. 17) and the building was first appraised by the Revenue Agent at $92,509.92, which appraised value was later reduced by the Commissioner to $64,245.68 (R. 10).

would, by necessary implication, carry with it the right to permit the building to remain upon the land, and such right would, of course, constitute an interest in the realty, the capital of the owner. Accordingly, it follows that instead of the increment of value to Respondent's capital having been severed from the capital, it became attached to and a part of it, and manifestly, it was neither severed from such capital nor severable. Being neither separated nor severable, Respondent received nothing of exchangeable value in the form of cash or its equivalent with which he could pay an income tax.[3] Respondent's position is no different than though he had procured the construction upon his premises of a building worth $64,245.68 at a cost of $12,811.43 (R. 14).[4] He was economically richer by $51,434.25. However, that does not differ from the result of any good bargain, and it is a well settled principle that the results of a good bargain do not constitute taxable income. *Palmer* v. *Commissioner*, 302 U. S. 63, 68-69; *Rose* v. *Trust Co.* (C.C.A. 5), 28 F.(2d) 767, 776, 778; *Commissioner* v. *VanVorst* (C.C.A. 9) 59 F.(2d) 677, 680; *Taplin* v. *Commissioner* (C.C.A. 6), 41 F.(2d) 454; *Rossheim* v. *Commissioner* (C.C.A. 3), 92 F.(2d) 247, 249; *Omaha National Bank* v. *Commissioner*

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[3] While by the stipulation it is agreed that the building had a fair market value of $64,245.68, it was never intended that that should mean any more than that $64,245.68 represented that portion of the fair market value of the building and the land which was properly allocable to the building. This is implicit in the Government's petition for writ of certiorari, wherein it states that the case is of general importance. Manifestly, if the Government had intended to contend that this case should be controlled by a technical construction of an inadvertent phrase contained in the stipulation, which is clearly contrary to well known facts, it could not have represented to this Court that the case was of general importance because in other cases the facts would be made to appear, and appearing they would be at once distinguishable from the instant case. Hence, we assume that the Government will agree that the stipulation with respect to value was intended to mean nothing more than that $64,245.68 represented that part of the fair market value of the land and building which was properly allocable to the building. Such agreements are very common in arriving at a basis for depreciation.

[4] The lessee placed a new building upon the premises in replacement of an old one having a depreciated cost of $12,811.43 (R. 14).

(C.C.A. 8), 75 F.(2d) 434, 436; *Everhart* v. *Commissioner*, 26 B.T.A. 318; *Geeseman* v. *Commissioner*, 38 B.T.A. 258, 264, acquiesced in by the Commissioner, C. B. 1939-1, page 13.

These principles have been recognized and applied by every court before which there has arisen the general question whether a lessor derives taxable income by reason of the construction on his premises of valuable improvements by a lessee,[5] with the exception of the Court of Claims in *M. E. Blatt Co.* v. *United States*, 23 F.Supp. 461, and the District Court for the Western District of Kentucky in *Kentucky Block Coal Co.* v. *Lucas*, 4 F.Supp. 266. The decision in the latter case was devoid of any analysis of the authorities. Both decisions were rejected by this Court in *M. E. Blatt Co.* v. *United States*, 305 U. S. 267.

The first case to reach a court appears to have been *Miller* v. *Gearin* (C.C.A. 9), 258 Fed. 225 (May 5, 1919). Therein, a building was placed upon the leased premises in 1907 and the lease was forfeited in 1916. The Commissioner determined that income resulted to the lessor upon the termination of the lease. The court held to the contrary, saying, page 226:

> The lessor acquired nothing in 1916 save the possession of that which for many years had been her own. The possession so acquired was not income.

Petition for writ of certiorari was denied, 250 U. S. 667.

The question was next considered in *Cryan* v. *Wardell* (N.D. Cal.), 263 Fed. 248 (February 2, 1920).

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[5] **M. E. Blatt Co. v. United States**, 305 U. S. 267; **Commissioner v. Center Investment Co.** (C.C.A. 9), 108 F.(2d) 190; **Commissioner v. Wood** (C.C.A. 7), 107 F.(2d) 869; **Helvering v. Bruun** (C.C.A. 8), 105 F.(2d) 442; **Nicholas v. Fifteenth Street Investment Co.** (C.C.A. 10), 105 F.(2d) 289; **Dominick v. United States** (D.C. S.D. N.Y.), 24 F.Supp. 829; **English v. Bitgood** (D.C. Conn.), 21 F.Supp. 641; **Staples et al v. United States** (D.C. E.D. Pa.), 21 F.Supp. 737; **Hilgenberg v. United States** (D.C. Md.), 21 F.Supp. 453; **Hewitt Realty Co. v. Commissioner** (C.C.A. 2), 76 F.(2d) 880; **Cryan v. Wardell** (N.D. Cal.), 263 Fed. 248; **Miller v. Gearin** (C.C.A. 9), 258 Fed. 225.

In that case the building was placed upon the leasehold in 1910 and the lease forfeited in 1916. The court held that whatever accretion in value resulted to plaintiff from the erection of the building in question accrued and became vested in the taxpayer in 1910, and hence that there was no gain upon a termination of the lease.

In *Hewitt Realty Co.* v. *Commissioner* (C.C.A. 2), 76 F.(2d) 880 (April 8, 1935), the question presented was whether the lessor derived income at the time the building was placed upon his land by the lessee. It was found that at the time of the completion of the building it had a fair market value of $559,842.32. However, in holding that no income resulted to the lessor the majority opinion considered and applied the fundamental principles which we have outlined above. It said, page 884:

> * * * We concede that in a situation like that at bar a lessor need not receive money to be taxable; if improvements to land be portable--detachable machinery for example, which he can take off and sell as separate chattels--he receives income either when the lease is made, or when the term ends; for present purposes we need not say which. *On the other hand, if the lease requires the lessee to drain the land, or set out shade trees, or pave it, or grade it, or build a golf course, or a race track on it, we can see no difference between the resulting increase in its value and that arising from the growth of the surrounding neighborhood, or the increase in value of a share of stock. The question as we view it is whether the value received is embodied in something separately disposable, or whether it is so merged in the land as to become financially a part of it, something which, though it increases its value, has no value of its own when torn away.*
>
> * * * Therefore, in our judgment if a building when removed be worthless, save as bricks, iron, and mortar, it becomes income only when the land is sold, and then only in so far as it increases the "amount realized" at that time--the minuend in the equation of gain. This answers every fiscal necessity, far more

directly and simply than any other formula. While the term lasts, the lessor gets nothing which benefits him but the rent; *when it ends, he gets land for which he can get a higher rent*--that is, if the building is neither outworn, nor outmoded. On all rents he must pay a tax. *If he sells at any time, pending the term or after it ends, the building will increase his gains; and his taxes in proportion. But a power to sell is not the same as a sale.* [Italics ours.]

In *Hilgenberg* v. *United States* (D.C. Md.), 21 F.Supp. 453 (November 27, 1937), the question presented was the same as that before the court in *Hewitt Realty Co.* v. *Commissioner*. After reviewing the cases which have been cited above and approving the reasoning of the majority opinion in the *Hewitt Realty Company* case, the court said, page 458:

> The theory underlying the present attitude of the Commissioner and all of the decisions of the Board of Tax Appeals appears to be founded on the misconception that, since the value of the improvements is not income at the time the lease is terminated, it must of necessity be income when they are completed. This, of course, is a *non sequitur*, because it need not be income at either time. * * *

In *Staples, et al* v. *United States* (D.C. E.D. Pa.), 21 F.Supp. 737 (December 31, 1937), the question presented was the same as that presented in each of the two foregoing cases. After a careful review of the decisions of this Court defining income, the court said, page 740:

> In the light of this authoritative definition I have reached the conclusion that the value of a building erected by a tenant on his own initiative and without any obligation to do so, which by reason of its being annexed to the freehold becomes the property of the landlord, is not income of the landlord until the land is sold or otherwise disposed of. * * *
>
> In the present case it seems clear to me that the value of the building permanently added to the land

by the tenant was at the most, in the words of Mr. Justice Pitney, but "a gain accruing to capital, * * * a growth or increment of value in the investment." It was not "something of exchangeable value, proceeding from the property, severed from the capital, * * * and coming in, being 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit and disposal."

In *English* v. *Bitgood* (D.C. Conn.), 21 F.Supp. 641 (January 5, 1938), the question again was whether income accrued to the landlord at the time the building was placed upon the premises. The court decided against the Government on the basis of the decision of the court in *Hewitt Realty Company* v. *Commissioner, supra.*

In *Dominick* v. *United States* (D.C. S.D. N.Y.), 24 F.Supp. 829 (January 30, 1938), the court had before it the question here presented, that is, whether gain accrues to the lessor upon the termination of the lease. The court felt that it was bound by the reasoning of the Circuit Court of Appeals in the *Hewitt Realty Company* case and, accordingly, found against the Government.

The question whether gain resulted to the lessor at the time of the construction of a building upon his premises by a lessee finally reached this Court in *M. E. Blatt Co.* v. *United States,* 305 U. S. 267 (December 5, 1938), and, in holding that no gain resulted to the lessor at the time the improvements became his, this Court said, page 279:

> Granting that the improvements increased the value of the building, that enhancement is not realized income of lessor so far as concerns taxable income. The value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute.

Thus, this Court in unequivocal language approved the reasoning of the courts rejecting the Government's

contention, and stated that even though improvements placed upon land by a lessee enhance the value of the land such value is not distinguishable from excess of value over cost of improvements made by the owner; each is an addition to capital, and neither constitute taxable income within the meaning of the statute. Language more decisive of the issue here presented could not well be employed.

Following the *Blatt Company* decision, the question whether income accrues to a lessor upon the cancellation of the lease to the extent of the value of improvements made upon the premises by the lessee during his tenancy came before the Circuit Court of Appeals for the Tenth Circuit in *Nicholas* v. *Fifteenth Street Investment Co.*, 105 F.(2d) 289 (June 19, 1939). The court rejected the Government's contention, saying, page 290:

> The improvements for which the lessee paid enhanced the value of the property, but the enhancement did not constitute realized income to the taxpayer during the years in question. It constituted an addition to capital instead of realized income within the meaning of the statute. Such an enhancement in value can result in realized income to the taxpayer only through increased rentals from the property after cancellation of the lease, or through the sale of the property. * * *

This decision was followed by the decision of the Circuit Court of Appeals herein, in *Helvering* v. *Bruun*, 105 F.(2d) 442 (July 10, 1939). After reviewing the authorities the court refused to support the Commissioner's position, saying, page 444:

> Under this rule the taxpayer in the present case is in the same position with respect to income that he would have been had he constructed a building upon his premises in 1933 worth $51,434.25 in excess of cost. Such a building would have added "enhanced" or "excess" value to the real estate in that year; but it would have been only "an addition to capital; not income."

The same question reached the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Wood*, 107 F.(2d) 869 (November 27, 1939), and in rejecting the Commissioner's contention, the court said, pages 871-872:

> Commissioner's position--that acquisition or possession by the lessor of leasehold improvements made by the lessee and worth $80,000 results in the realization of income--is plausible, but we are not ready to indorse it. To us leasehold improvements may constitute taxable income to the lessor, within the meaning of the taxing statute, only if in a form more definite than a mere acquisition of title or possession, or an increase in value of the property to which they are affixed. That is to say, in our minds leasehold improvements can result in taxable income to the lessor only through increased rentals from the property after cancellation of the lease, or through the sale of the property. * * *
>
> If a taxpayer had constructed a building on his land in 1932 worth $80,000 in excess of cost, he would not have been chargeable with taxable income, although such an improvement would have increased the value of his land. We believe that the taxpayer in the instant case is in no different situation and consequently that he should be treated in the same way. *Moreover, what has the lessor in the instant case received, from which he can pay the tax on* $80,000? Since his income is in the form of a capital asset, he has received nothing with which to pay the tax.
>
> *In such cases, common sense dictates that the taxpayer by necessity must wait for his income until there is a conversion into cash or its substantial equivalent.* See *Eisner* v. *Macomber*, 252 U. S. 189, 207, 208, * * * Nor does such a construction of the taxing statute work a disadvantage to the Government. The Government will collect its tax, if the taxpayer sells or exchanges the property. On the other hand, if the taxpayer elects to hold the property upon repossession, the Government will tax the entire earnings therefrom, as long as the building is valuable enough to produce net income. [Italics ours.]

In *Commissioner* v. *Center Investment Company*, 108 F.(2d) 190 (November 27, 1939), the Circuit Court of Appeals for the Ninth Circuit reaffirmed its decision in *Miller* v. *Gearin, supra*, saying, page 191:

> We are of the view that no such change in kind or extent of the taxpayer's rights was occasioned by the forfeiture as to constitute a "severance" or "realization" of income. * * *
>
> * * * Any increase in value accruing to that asset in the year of forfeiture of the lease constituted increase in economic worth but not realized income. * * *

The Board of Tax Appeals has likewise been consistent in holding that no gain accrues to a lessor upon the termination of a lease, even though the lessee has constructed a valuable building thereon.[6]

Cleveland Trust Co. v. *Commissioner*, 39 B.T.A. 113, was decided after the decision of this Court was handed down in the *Blatt Company* case. The Board reaffirmed its position, saying:

> * * * However, in the *Blatt* case, *supra*, the Supreme Court considered the validity of that regulation. It is true the Court there had to decide only "whether, under the lease here involved, one-tenth of what the commissioner and taxpayer call and agree to be 'estimated depreciated value,' as of the end of the term, was income to petitioner in the first year of the term." But, in disposing of that question on the facts there before the Court, the majority opinion clearly invalidates the regulation under which the respondent acted here, and says:
>
> "Granting that the improvements increased the value of the building, the enhancement is not realized income of lessor. So far as concerns taxable in-

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[6] **Scott v. Commissioner**, 9 B.T.A. 1219; **Alexander v. Commissioner**, 13 B.T.A. 1169; **Martin v. Commissioner**, 24 B.T.A. 813; **Slack v. Commissioner**, 35 B.T.A. 271, petition for review dismissed (C.C.A. 9), 91 F.(2d) 1011; **Durkheimer Investment Co. v. Commissioner**, 36 B.T.A. 423; **F. S. Stimson Corp. v. Commissioner**, 38 B.T.A. 303, 307; **Cleveland Trust Co. v. Commissioner**, 39 B.T.A. 113.

come, the value of the improvements is not distinguishable from excess, if any there may be, of value over cost of improvements made by lessor. Each was an addition to capital; not income within the meaning of the statute. Treasury Regulations can add nothing to income as defined by Congress."

In view of that unequivocal expression by the Supreme Court, we now hold that where, as here, the improvements to the leasehold do not constitute rent and, when constructed, became a part of the leased premises, and if removed, had only a salvage value, no taxable income is realized by their lessor upon its acquisition of possession of such premises at the termination of the lease.

Thus, we have an unbroken line of decisions of this Court holding that before income can be said to be derived from capital it is necessary not only that there be a growth or increment of value in the property, but there must be something of exchangeable value *severed* from the property and received by the taxpayer for his *separate use, benefit,* and *disposal,* and, with the two exceptions noted above, we also have an unbroken line of decisions of the courts running from May 5, 1919, down to the present date, applying that definition of income to the question whether taxable income accrues to a lessor by reason of valuable improvements being placed upon his land by a lessee, and in each instance reaching a negative conclusion. The Board of Tax Appeals has also been consistent in its holding that no income results to a lessor under facts such as those here presented. We respectfully submit that those decisions are sound.

It is difficult to understand how this Court can reach a different conclusion without radically changing the definition of income as that term is used in the Sixteenth Amendment to the Constitution, and in all of the Revenue Acts adopted since that time and as it has come to be well understood in the general administration of the income tax statutes. If the Government should prevail in procuring the decision it seeks, instead of clarifying

the income tax laws it will throw the entire structure of the statutes into confusion and give rise to new and endless litigation.

Petitioner contends that the tax is valid, even though that which is sought to be taxed does not constitute income within the meaning of that term as used in the Sixteenth Amendment to the Constitution (Br. 23-25). He says:

> * * * However, it seems clear that a tax upon such gain is valid wholly apart from the Sixteenth Amendment since it is not a direct tax. And in any event the tax is valid since the Sixteenth Amendment was intended "to get rid of nice questions as to what might be direct taxes". * * *

The manifest fallacy of this argument is, first, that in the enactment of all of the income tax laws since 1913, Congress has very obviously intended to exercise only the powers granted to it by the Sixteenth Amendment; second, the several cases of this Court referred to above had to do with a definition of income under statutes practically identical to Section 22(a) of the Revenue Act of 1932; and third, the tax is what it purports to be, an *income* tax, and, as we have stated above, such a tax cannot be converted into a capital levy (*Koshland* v. *Helvering*, 298 U. S. 441, 445-446) or some other form of tax other than that which Congress intended it to be. Manifestly, we are not concerned with that which Congress might have done. Our concern is with that which Congress did.

Petitioner also contends (Br. 14-15):

> * * * Indeed, even the *purchase* of property at a price substantially less than its fair market value may, under certain circumstances, be treated as an income producing transaction.

The difficulty with this contention is, first, that it is not supported by the authorities cited. *Salvage* v. *Com-*

missioner (C.C.A. 2), 76 F.(2d) 112, 114, merely holds that under the particular facts of that case the difference between the fair market value of the stock received and the $150,000 paid therefor constituted consideration to the purchaser "for his covenant not to compete". Manifestly, any money or its equivalent in cash paid to a person "for his covenant not to compete" with another would constitute income. That is a far cry from "the *purchase* of property at a price substantially less than its fair market value". In the case of *Elverson Corp.* v. *Commissioner*, 40 B.T.A. 614, the Board held that the taxpayer had exchanged certain notes for shares of stock "enhanced in value by the morning and Sunday editions of the Public Ledger", and that gain resulted to the taxpayer measured by the difference between the cost of the notes and the cash equivalent of the property it received in exchange. The situation was no different in that case than in any case where there is an exchange of property for other property having a value readily convertible into cash.

The second and fatal difficulty with Petitioner's contention is that it has been flatly rejected by this and other courts. *Palmer* v. *Commissioner*, 302 U. S. 63, 68-69, and see other cases cited at page 13, *supra*.

The Petitioner cites (Br. 14) numerous cases holding that income may be received in the form of property. However, an examination of those cases will disclose that in each instance the taxpayer received property which was separately disposable and readily convertible into cash. They have no bearing upon the issue here presented.

Conclusion

The Petitioner has failed to cite any case which has not been either overruled or rejected, which supports the sought departure from the principles laid down and followed by this Court ever since *Eisner* v. *Macomber*, *supra*.

On the other hand, we have shown that this Court has consistently followed that decision and held that in order to derive taxable income from capital there must be, first, an increment of value in the capital, and second, such a severance of that increment of value as to make it subject to the separate use and disposal of the owner. The taxpayer must have received something separate and apart from his capital out of which he can pay his tax. We have shown that by a unanimity of opinion seldom found in dealing with any supposedly controversial question, both the courts and the Board of Tax Appeals have applied these general principles to facts similar to those here presented, and have held that no taxable gain results to the lessor. Those decisions are consonant with principles weighed in the test of time accepted by Congress and by common judgment approved. Their overthrow would result in endless confusion. The decision below invalidating the tax should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 479.—October Term, 1939.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, vs. Charles A. Bruun. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[March 25, 1940.]

Mr. Justice Roberts delivered the opinion of the Court.

The controversy had its origin in the petitioner's assertion that the respondent realized taxable gain from the forfeiture of a leasehold, the tenant having erected a new building upon the premises. The court below held that no income had been realized.[1] Inconsistency of the decisions on the subject led us to grant certiorari.

The Board of Tax Appeals made no independent findings. The cause was submitted upon a stipulation of facts. From this it appears that on July 1, 1915, the respondent, as owner, leased a lot of land and the building thereon for a term of ninety-nine years. The lease provided that the lessee might, at any time, upon giving bond to secure rentals accruing in the two ensuing years, remove or tear down any building on the land, provided that no building should be removed or torn down after the lease became forfeited, or during the last three and one-half years of the term. The lessee was to surrender the land, upon termination of the lease, with all buildings and improvements thereon.

In 1929 the tenant demolished and removed the existing building and constructed a new one which had a useful life of not more than fifty years. July 1, 1933, the lease was cancelled for default in payment of rent and taxes and the respondent regained possession of the land and building.

The parties stipulated "that as at said date, July 1, 1933, the building which had been erected upon said premises by the lessee had a fair market value of $64,245.68 and that the unamortized cost of the old building, which was removed from the premises in 1929

[1] Helvering v. Bruun, 105 F. (2d) 442.

to make way for the new building, was $12,811.43, thus leaving a net fair market value as at July 1, 1933, of $51,434.25, for the aforesaid new building erected upon the premises by the lessee."

On the basis of these facts, the petitioner determined that in 1933 the respondent realized a net gain of $51,434.25. The Board overruled his determination and the Circuit Court of Appeals affirmed the Board's decision.

The course of administrative practice and judicial decision in respect of the question presented has not been uniform. In 1917 the Treasury ruled that the adjusted value of improvements installed upon leased premises is income to the lessor upon the termination of the lease.[2] The ruling was incorporated in two succeeding editions of the Treasury Regulations.[3] In 1919 the Circuit Court of Appeals for the Ninth Circuit held in *Miller* v. *Gearin*, 258 Fed. 225, that the regulation was invalid as the gain, if taxable at all, must be taxed as of the year when the improvements were completed.[4]

The regulations were accordingly amended to impose a tax upon the gain in the year of completion of the improvements, measured by their anticipated value at the termination of the lease and discounted for the duration of the lease. Subsequently the regulations permitted the lessor to spread the depreciated value of the improvements over the remaining life of the lease, reporting an aliquot part each year, with provision that, upon premature termination, a tax should be imposed upon the excess of the then value of the improvements over the amount theretofore returned.[5]

In 1935 the Circuit Court of Appeals for the Second Circuit decided in *Hewitt Realty Co.* v. *Commissioner*, 76 F. (2d) 880, that a landlord received no taxable income in a year, during the term of the lease, in which his tenant erected a building on the leased land. The court, while recognizing that the lessor need not receive money to be taxable, based its decision that no taxable gain was realized in that case on the fact that the improvement was not portable or detachable from the land, and if removed would be worthless except as bricks, iron, and mortar. It said (p. 884): "The question as we

[2] T. D. 2442, 19 Treas. Dec. Int. Rev. 25.

[3] Regulations 33 (1918 Ed.) Art. 4, ¶ 50; Regulations 45 (2d 1919 Ed.) Art. 48.

[4] This court denied certiorari, 250 U. S. 667.

[5] T. D. 3062, 3 Cum. Bull. 109; Regulations 45 (1920 Ed.), Art. 48; Regulations 62, 65, and 69, Art. 48; Regulations 86, 94, and 101, Art. 22(a) —13.

view it is whether the value received is embodied in something separately disposable, or whether it is so merged in the land as to become financially a part of it, something which, though it increases its value, has no value of its own when torn away."

This decision invalidated the regulations then in force.[6]

In 1938 this court decided *M. E. Blatt Co. v. United States*, 305 U. S. 267. There, in connection with the execution of a lease, landlord and tenant mutually agreed that each should make certain improvements to the demised premises and that those made by the tenant should become and remain the property of the landlord. The Commissioner valued the improvements as of the date they were made, allowed depreciation thereon to the termination of the leasehold, divided the depreciated value by the number of years the lease had to run, and found the landlord taxable for each year's aliquot portion thereof. His action was sustained by the Court of Claims. The judgment was reversed on the ground that the added value could not be considered rental accruing over the period of the lease; that the facts found by the Court of Claims did not support the conclusion of the Commissioner as to the value to be attributed to the improvements after a use throughout the term of the lease; and that, in the circumstances disclosed, any enhancement in the value of the realty in the tax year was not income realized by the lessor within the Revenue Act.

The circumstances of the instant case differentiate it from the *Blatt* and *Hewitt* cases; but the petitioner's contention that gain was realized when the respondent, through forfeiture of the lease, obtained untrammeled title, possession and control of the premises, with the added increment of value added by the new building, runs counter to the decision in the *Miller* case and to the reasoning in the *Hewitt* case.

The respondent insists that the realty,—a capital asset at the date of the execution of the lease,—remained such throughout the term and after its expiration; that improvements affixed to the soil became part of the realty indistinguishably blended in the capital asset; that such improvements cannot be separately valued or treated as received in exchange for the improvements

[6] The Hewitt case was followed in Hilgenberg v. United States, 21 F. Supp. 453, Staples v. United States, 21 F. Supp. 737, and English v. Bitgood, 21 F. Supp. 641.

which were on the land at the date of the execution of the lease; that they are, therefore, in the same category as improvements added by the respondent to his land, or accruals of value due to extraneous and adventitious circumstances. Such added value, it is argued, can be considered capital gain only upon the owner's disposition of the asset. The position is that the economic gain consequent upon the enhanced value of the recaptured asset is not gain derived from capital or realized within the meaning of the Sixteenth Amendment and may not, therefore, be taxed without apportionment.

We hold that the petitioner was right in assessing the gain as realized in 1933.

We might rest our decision upon the narrow issue presented by the terms of the stipulation. It does not appear what kind of a building was erected by the tenant or whether the building was readily removable from the land. It is not stated whether the difference in the value between the building removed and that erected in its place accurately reflects an increase in the value of land and building considered as a single estate in land. On the facts stipulated, without more, we should not be warranted in holding that the presumption of the correctness of the Commissioner's determination has been overborne.

The respondent insists, however, that the stipulation was intended to assert that the sum of $51,434.25 was the measure of the resulting enhancement in value of the real estate at the date of the cancellation of the lease. The petitioner seems not to contest this view. Even upon this assumption we think that gain in the amount named was realized by the respondent in the year of repossession.

The respondent can not successfully contend that the definition of gross income in Sec. 22(a) of the Revenue Act of 1932[7] is not broad enough to embrace the gain in question. That definition follows closely the Sixteenth Amendment. Essentially the respondent's position is that the Amendment does not permit the taxation of such gain without apportionment amongst the states. He relies upon what was said in *Hewitt Realty Co.* v. *Commissioner*, *supra*, and upon expressions found in the decisions of this court dealing with the taxability of stock dividends to the effect that gain derived from capital must be something of ex-

[7] c. 209, 47 Stat. 169, 178.

changeable value proceeding from property, severed from the capital, however invested or employed, and received by the recipient for his separate use, benefit, and disposal.[8] He emphasizes the necessity that the gain be separate from the capital and separately disposable. These expressions, however, were used to clarify the distinction between an ordinary dividend and a stock dividend. They were meant to show that in the case of a stock dividend, the stockholder's interest in the corporate assets after receipt of the dividend was the same as and inseverable from that which he owned before the dividend was declared. We think they are not controlling here.

While it is true that economic gain is not always taxable as income, it is settled that the realization of gain need not be in cash derived from the sale of an asset. Gain may occur as a result of exchange of property, payment of the taxpayer's indebtedness, relief from a liability, or other profit realized from the completion of a transaction.[9] The fact that the gain is a portion of the value of property received by the taxpayer in the transaction does not negative its realization.

Here, as a result of a business transaction, the respondent received back his land with a new building on it, which added an ascertainable amount to its value. It is not necessary to recognition of taxable gain that he should be able to sever the improvement begetting the gain from his original capital. If that were necessary, no income could arise from the exchange of property; whereas such gain has always been recognized as realized taxable gain.

Judgment reversed.

The CHIEF JUSTICE concurs in the result in view of the terms of the stipulation of facts.

Mr. Justice MCREYNOLDS took no part in the decision of this case.

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[8] See Eisner v. Macomber, 252 U. S. 189, 207; United States v. Phellis, 257 U. S. 156, 169.

[9] Cullinan v. Walker, 262 U. S. 134; Marr v. United States, 268 U. S. 536; Old Colony Trust Co. v. Commissioner, 279 U. S. 716; United States v. Kirby Lumber Co., 284 U. S. 1; Helvering v. American Chicle Co., 291 U. S. 426; United States v. Hendler, 303 U. S. 564.